

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D48/97

Profits tax – profit derived from sale of property – whether assessable to profits tax.

Panel: Robert Wei Wen Nam SC (chairman), Philip Lam Bing Lun and Nigel A Rigg.

Date of hearing: 14 May 1997.

Date of decision: 10 September 1997.

The taxpayer appeals against the profits tax assessment raised on him for the year of assessment 1992/93 in respect of the profit derived from the sale of a flat. On 7 July 1991 the taxpayer acquired the subject flat for \$1,660,000. The acquisition was financed by a mortgage loan repayable by 170 monthly instalments of \$16,283 effective 23 September 1991. On 23 March 1992, the taxpayer disposed of the subject flat for \$2,340,000. The sale was completed on 19 June 1992. The taxpayer's case is that he acquired the subject flat solely for his own use and that he sold it because of the problem of cash shortage which he had at the time of sale. His annual income for the period from 1 April 1991 to 31 March 1992 was \$120,000. He could not support the monthly repayment of the mortgage loan in the sum of \$16,283 when the monthly income was only \$10,000. He stated that he sold the subject flat to relieve the cash shortage of a private limited company in which he was interested.

Held:

The Board found that the taxpayer resided in the subject flat during the period of his ownership. The Board was not satisfied on a balance of probabilities that he began his residence with a long-term investment intention and a reasonable prospect of being able to carry it into effect. On the contrary, the Board found that the purchase and sale of the subject flat was an adventure in the nature of trade and that the subject flat was acquired as a trading asset. The profit on sale thereof is trading profit and assessable to profits tax.

Appeal dismissed.

Cases referred to:

Simmons v CIR 53 TC 461 at 491

Cunliffe v Goodman [1950] 2 KB 237 at 253

D11/80, IRBRD, vol 1, 374

All Best Wishes Ltd v CIR 3 HKTC 750 at 771

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J R Smith for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

Nature of appeal

1. This is an appeal by an individual (the Taxpayer) against the profits tax assessment raised on him for the year of assessment 1992/93. The Taxpayer contends that the profit in question is capital profit, that is, profit derived from the realisation of a long-term investment.

Facts not in dispute

2. By a provisional agreement for sale and purchase dated 7 July 1991 the Taxpayer agreed to purchase Flat A (the Subject Flat) for a consideration of \$1,660,000. That was followed by the signing of a formal agreement for sale and purchase dated 23 July 1991, and the purchase was completed on 23 August 1991. The purchase was financed by a mortgage loan repayable by 170 monthly instalments of \$16,283 effective 23 September 1991.

3. By a provisional agreement for sale and purchase dated 23 March 1992, the Taxpayer agreed to sell the Subject Flat for a consideration of \$2,340,000. That was followed by the signing of a formal agreement for sale and purchase dated 6 April 1992, and the sale was completed on 19 June 1992.

4. On 5 August 1991, the Taxpayer purchased Flat B (the Second Flat) for a consideration of \$1,770,000. Within the year ended 31 March 1992, the Taxpayer sold the Second Flat.

5. On 2 September 1991, the Taxpayer purchased Flat C (the Third Flat) for a consideration of \$1,280,000. The Taxpayer has since sold the Third Flat.

6. On 22 March 1994, the assessor raised the following profits tax assessment on the Taxpayer for the year of assessment 1991/92 in respect of an estimated profit derived from the sale of the Second Flat:

Estimated assessable profits	\$80,000
Tax payable thereon	<u>\$12,000</u>

The Taxpayer raised no objection against the assessment and paid the tax payable thereon.

7. On 22 March 1994 the assessor raised the following profits tax assessment on the Taxpayer for the year of assessment 1992/93 in respect of an estimated profit derived from the sale of the Subject Flat:

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Estimated assessable profits	\$450,000
Tax payable thereon	<u>\$67,500</u>

8. By letter dated 1 April 1994 the Taxpayer objected to the year of assessment 1992/93. The grounds of objection may be summarised as follows.

8.1 The Subject Flat was solely for his own use during the whole period of his ownership (that is, 23 August 1991 to 19 June 1992).

8.2 He would not have sold the Subject Flat had it not been for the problem of cash shortage at the time of sale. His income had dropped to \$120,000 in 1991/92 as compared to \$239,803 in 1988/89. Thus he was financially in trouble in mid-1992. He was forced to sell the Subject Flat and rent a flat from that time onwards.

8.3 He had no intention to attract any purchaser or to sell the Subject Flat at all when he bought it.

8.4 He was in urgent need of money at that time and the sale was compulsory in order to meet the need.

9. By letter dated 11 August 1994 the assessor requested the Taxpayer to furnish information, namely, (a) a list of the properties in which he resided during the period 1 January 1991 to date, showing for each property the address, period of residence thereat, and details of other persons residing with him, (b) a detailed account of the net gain on disposal of the Subject Flat and the Second Flat and (c) details and evidence of the financial difficulties which the Taxpayer claimed forced him to sell the Subject Flat.

10. By letter dated 5 October 1994 the Taxpayer replied that the tax for the Second Flat had already been paid and that the case was considered to be discharged, and he requested the assessor to 'clarify the necessary information' which the assessor required.

11. By letter dated 19 October 1994 the assessor confirmed to the Taxpayer that all of the information requested in his letter dated 11 August 1994 was required to be furnished by the Taxpayer.

12. The Taxpayer has not furnished the information requested.

13. The Commissioner of Inland Revenue determined the objection against the Taxpayer and confirmed the assessment in question.

Statement of grounds of appeal

14. The Taxpayer's statement of grounds of appeal may be summarised as follows.

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14.1 The Taxpayer owned the Subject Flat for 300 days, that is, from 23 August 1991 to 19 June 1992 and not for less than 9 months as stated by the Commissioner in her determination.

14.2 The Taxpayer has submitted evidence of residence in the Subject Flat (that is, a bank's advice). The Taxpayer would be willing to provide any other evidence the assessor might require had he so informed the Taxpayer.

14.3 The Taxpayer has already provided details of his financial problems. His annual income had dropped from \$239,803 to \$120,000 which is equivalent to \$10,000 per month. How can the Taxpayer support the monthly repayment for the mortgaged property in the sum of \$16,283.87 when the monthly income was only \$10,000? This evidence is sufficient to substantiate the financial problems. There is no reason why the assessor should still say that the details had not been provided.

14.4 As for the purchase of the Second Flat, the case is considered discharged and is irrelevant to this appeal.

14.5 The Taxpayer was very upset by the assessor's request for information (see paragraph 9 above), particularly by the request for details of other persons residing with the Taxpayer. This is completely unacceptable when human rights are considered.

The law

15. The following propositions will be applied.

15.1 Trading requires an intention to trade. Was the asset acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? It is not possible for an asset to be both trading stock and permanent investment at the same time, nor to possess an indeterminate status – neither trading stock nor permanent asset (per Lord Wilberforce in Simmons v CIR 53 TC 461 at 491).

15.2 An intention connotes a state of affairs which X decides, so far as in him lies, to bring about, and which, in point of possibility, he has a reasonable prospect of being able to bring about by his own act of volition. X cannot be said to 'intend' a result which is wholly beyond the control of his will. He cannot 'intend' that it shall be a fine day to-morrow. At most he can hope or desire or pray that it will. Nor can X be said to 'intend' a particular result ... if X's volition is no more than a minor agency collaborating with, or not thwarted by, the factors which predominantly determine its occurrence (per Asquith, LJ in Cunliffe v Goodman [1950] 2 KB 237 at 253).

15.3 'Intention' connotes an ability to carry it into effect. It is idle to speak of 'intention' if the person so intending did not have the means to bring it about or had made no arrangements or taken any steps to enable such intention to be implemented (D11/80, IRBRD, vol 1, 374).

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15.4 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 (per Mortimer J in All Best Wishes Ltd v CIR 3 HKTC 750 at 771).

15.5 A permanent or long-term investment is a capital asset. Profit arising from the sale of a capital asset is not taxable, while profit arising from the sale of a trading asset is. In this case, the onus is on the Taxpayer to prove that the assessment under appeal is incorrect (see section 68(4) of the Inland Revenue Ordinance) and, for that purpose, to prove that the Subject Flat was acquired with the intention of holding it as a permanent or long-term investment.

Evidence

16. At the hearing of this appeal, the Taxpayer appeared in person while Mr Smith represented the Commissioner. No witnesses were called. The statements of fact made by the Taxpayer in the course of his submission are treated as his evidence and dealt with the following paragraphs.

Findings and reasons

17. The Taxpayer's case is that he acquired the Subject Flat solely for his own use and that he sold it because of the problem of cash shortage which he had at the time of sale. He produced some 45 documents, including invoices, receipts, and a copy salaries tax return, to prove his residence at the Subject Flat. Having read the documents, we are satisfied that the accumulative effect of some of them proves that the Taxpayer resided in the Subject Flat during the whole period of his ownership. In making that finding we did not take into account an additional document which the Taxpayer sent to the Clerk to the Board of Review after the hearing of this appeal.

18. The crux of this appeal lies in the intention with which the Taxpayer acquired the Subject Flat. The onus is on him to prove to our satisfaction that, at the time of the acquisition, his intention was to hold the Subject Flat as a permanent or long-term investment (see paragraph 15.5 above). Since intention connotes ability to carry it into effect (see paragraphs 15.2 and 15.3 above), the Taxpayer has to prove to our satisfaction that, at the time of acquisition, he had a reasonable prospect of being able to hold the Subject Flat on a permanent or long-term basis, and was so placed that he could reasonably

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expect that he would be able to pay off all of the 170 monthly instalments of \$16,283 each (see paragraph 2 above).

19. The Taxpayer produced no evidence to prove his ability to hold the Subject Flat as a long-term investment except to say that his banker approved his application for the mortgage loan and that, he contended, was proof enough. With respect, we disagree. A consideration of paramount importance for the banker is the value of the security of the mortgaged property, which can be sold to repay the mortgage debt if the customer defaults in making repayments. Therefore, just because one succeeds in obtaining a mortgage loan from a banker, it does not necessarily follow that one is able to hold the property as a long-term investment. The practical question for this appeal is whether, at the time of acquisition, the Taxpayer has a reasonable prospect of being able to pay off all of the 170 monthly instalments without having to sell the Subject Flat.

20. The Taxpayer offered two reasons for the sale. In our view, they do not help to establish a long-term investment intention at the time of acquisition. The first reason was first mentioned at the objection stage and repeated as a ground of appeal (see paragraphs 8.2 and 14.3 above). He stated, and we accept, that his annual income for the period from 1 April 1991 to 31 March 1992 was \$120,000 which was equivalent to \$10,000 per month. He asked the rhetorical question: How could he support the monthly repayment of the mortgaged property in the sum of \$16,283 when the monthly income was only \$10,000? That argument does not help the Taxpayer's case of a long-term investment intention. The inadequacy of his income in terms of sustaining the mortgage instalments calls for an explanation as to how, at the time of acquisition (that is, on 7 July 1991), he could still have reasonably expected that he would be able to clear all of the 170 monthly instalments. A similar explanation is also due in respect of the acquisition of the Second and Third Flats on 5 August 1991 and 2 September 1991 respectively (see paragraphs 4 and 5 above). But no explanation was forthcoming.

21. At the hearing, the Taxpayer put forward for the first time another reason for the sale, that is, to relieve the cash shortage of a private limited company in which he was interested. Briefly the story is as follows. The company carried on the business of a concrete pump hiring service. It was a business which he had taken over from his brother-in-law. He started running that business as his own business in the year of assessment 1991/92. Previously he had been a quantity surveyor working for a consultant company. The pump hiring company was losing money. It made a loss of \$642,241 in 1992 and \$948,428 in 1993. He had to sell the Subject Flat to get cash. The \$120,000 which he had received during the period from 1 April 1991 to 31 March 1992 was director's fee from the company.

22. There is no evidence to show the extent of the Taxpayer's interests in the company nor to establish that the proceeds of sale of the Subject Flat were in fact utilised to relieve the cash shortage of the company. Further, assuming for argument's sake that that is the case, the Taxpayer would still have to prove the existence at the time of the acquisition of a long-term-investment intention and a reasonable prospect of being able to carry it into effect. The loss of \$642,241 in the year ended 31 December 1992 was, as the audited

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accounts show, as to \$628,527 thereof a loss made in the year ended 31 December 1991 and carried forward to the year 1992; the loss made in 1992 was only \$13,714. When the Subject Flat was acquired in July 1991, it was past the midpoint of that year. It was for the Taxpayer to show (and he did not) how, at the time of acquisition, he could still have a reasonable prospect of being able to pay off all of the 170 monthly mortgage instalments without having to sell the Subject Flat.

23. The Taxpayer acquired three properties in quick succession: the Subject Flat in July 1991, the Second Flat in August 1991 and the Third Flat in September 1991 (see paragraphs 4 and 5 above). All three were financed in a similar manner: 10% down and a mortgage loan repayable by monthly instalments. The Taxpayer stated that all three were bought, not as trading assets, but as investments. He had bought the Subject Flat as a residence but was forced to sell it in order to solve the problem of cash shortage. He bought the Second Flat for rent yield, but that was a mistake, because the rent yield was not as good as he had expected and he could not rent it out, so, he said, he had to sell it, even though he made a profit in the process. We are unable to accept that. The profit was estimated at \$80,000 by the assessor and was the subject of a profits tax assessment for 1991/92, and the Taxpayer paid the tax payable thereon without objection (see paragraph 6 above). The payment is an admission on the part of the Taxpayer that the Second Flat was a trading asset and that the sale was a trading transaction, so that profit arising from the sale was assessable to profits tax. As for the Third Flat, the Taxpayer stated that it was not for trading but was rented out, and that he sold it because of cash flow problem. The Revenue had information that the Second Flat was sold on 31 October 1991 at \$2,068,000 whereas the Third Flat was sold on 3 October 1994 at \$2,200,000. As the information was not confirmed by the Taxpayer, we have decided to leave it out of account. The Taxpayer stated that he could not recall how much he sold the Third Flat for because it was a disaster. We are unable to accept the truth of that statement. The manner in which the Taxpayer dealt with the purchase and sale of the Second and Third Flats did not enhance his general credibility.

24. We have found that the Taxpayer resided in the Subject Flat during the period of his ownership, but, for the reasons stated above, we are not satisfied on a balance of probabilities that he began his residence with a long-term investment intention and a reasonable prospect of carrying it into effect. On the contrary, we find that the purchase and sale of the Subject Flat was an adventure in the nature of trade and that the Subject Flat was acquired as a trading asset. Profit on sale thereof is trading profit and assessable to profits tax. Assuming (without finding) that the proceeds of sale were used to relieve cash shortage, that does not affect the findings we have made above.

25. Before we conclude this decision, we should mention that, in our view, the assessor was entitled to make the enquiries by his letter dated 11 August 1994 (see paragraph 9 above). There is no substance in the criticisms in the grounds of appeal (see in particular paragraph 14.5 above).

26. It follows that this appeal fails and that the profits tax assessment in question is hereby confirmed.