

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D49/02

Profits tax – real property – whether the gain arising from the disposition of a property was liable for profits tax – sections 2, 14(1) and 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Patrick Fung Pak Tung SC (chairman), Daisy Tong Yeung Wai Lan and Stephen Yam Chi Ming.

Date of hearing: 9 May 2002.

Date of decision: 7 August 2002.

By an undated provisional agreement for sale and purchase, the taxpayer agreed to purchase the property which was still under construction in District B. The occupation permit in respect of the property was dated 11 April 1997. By deed of assignment dated 16 July 1997, the property was assigned to the taxpayer. By a provisional agreement for sale and purchase dated 6 August 1997 and an agreement for sale and purchase dated 20 August 1997, the taxpayer agreed to sell the property. The sale was completed on 17 November 1997.

The taxpayer was married in 1980 and had three children. She became separated from her husband in 1992. However she and her children continued to live with her mother-in-law in Property 1 which was owned by her mother-in-law in District C. Her marriage was dissolved in September 1996. In her tax return for the year of assessment 1997/98, the taxpayer declared that her residential address was Property 1.

The taxpayer's case was that she purchased the property with a view to using it as a residence for herself and her children because after the divorce with her husband she felt that she could no longer live with her mother-in-law in Property 1. She chose to buy the property because she wanted to live near her mother. Further, she had been threatened and harassed on the telephone by her husband's mistress. She was expecting to receive financial assistance from her sisters. She had to sell the property eventually because one of her sisters could no longer assist her. Furthermore, she could not find suitable schools for her children in the vicinity of the property.

Held:

1. 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. The Board found the allegation that she was expecting financial assistance from her sisters

INLAND REVENUE BOARD OF REVIEW DECISIONS

unconvincing. The Board also found her allegation that she could no longer live with her mother-in-law after the divorce to be unconvincing, in light of the fact that she and her children continued to live with her mother-in-law after her separation with her husband in 1992 and had continued to do so even at the date of the hearing of the appeal. As regards the allegation of her trying to avoid interference and harassment by her husband's mistress, the problem would not have been solved by the taxpayer agreeing to purchase the property because the development was not to be completed until after April 1997. The most telling feature against the taxpayer was that she did not appear to have taken her children's schooling seriously into consideration when she agreed to purchase the property in September 1996. She had not given evidence of what effort or genuine effort she had made in looking for suitable schools for her children if they were really to move from District C to District B. Furthermore, after the taxpayer had sold the property and made a profit, she did not use the proceeds to purchase another property as a residence for herself and her children but decided to invest in shares in the stock market. This is hardly supportive of her claim that she purchased the property for such purpose in the first place.

2. 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 for the purpose of a long term investment and not for a trade at the time of such acquisition. 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 realisable. The Board came to the conclusion that the taxpayer had not discharged this 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

Chow Cheong Po for the Commissioner of Inland Revenue.
Taxpayer in person.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Decision:

1. This is an appeal by the Appellant ('the Taxpayer') against a profits tax assessment for the year of assessment 1997/98 raised on her. An objection was lodged by the Taxpayer against such assessment. The original assessment was on the basis of assessable profits of \$961,925 with tax payable in the sum of \$129,859. By his letter dated 31 January 2002, the Respondent ('the Commissioner') made a determination and rejected the Taxpayer's objection. By the same letter, the Commissioner further increased the assessable profits to \$1,271,925 with tax payable in the sum of \$171,709. The Taxpayer has brought this appeal against such determination ('the Determination').

The facts

2. The relevant facts as set out in the Determination have not been disputed by the Taxpayer. It is convenient for us to adopt them as set out below:

(2) The Taxpayer was married to [Mr A] in 1980. Her three children were born in 1981, 1983, and 1987 respectively.

(3) By an undated provisional agreement for sale and purchase, the Taxpayer agreed to purchase the property at [a housing estate in District B] ("the Property") at a consideration of \$3,172,275. The Property was still under construction at the time of the purchase.

(4) The payment terms as provided for in the provisional agreement for sale and purchase were as follows:

| <u>Payment</u> | <u>Amount</u> | <u>Payable</u> |
|--------------------------------|-------------------|-------------------------------|
| | \$ | |
| Initial deposit | 320,000 | |
| Further deposit | 314,455 | within 14 days of the date of |
| signing of the formal sale and | | purchase agreement, |
| | | was 24 September 1996 |
| Balance of purchase price | 2,537,820 | within 14 days of notice of |
| | <u>completion</u> | |
| | <u>3,172,275</u> | |

which

(5) By a divorce jurisdiction dated 27 September 1996, the Judge of the District Court decreed that the marriage between the Taxpayer and [Mr A] be dissolved. The Judge ordered that the children were to remain in the custody

INLAND REVENUE BOARD OF REVIEW DECISIONS

of the Taxpayer and [Mr A] was to pay to the Taxpayer for the maintenance of the three children of the family a sum of \$15,000 per month commencing on 1 June 1996. The Judge also ordered that [Mr A] was to pay the Taxpayer a nominal sum of \$1 per annum for her maintenance as and from the date on which the decree was made absolute.

- (6) (a) The occupation permit in respect of the Property was dated 11 April 1997.
- (b) By deed of assignment dated 16 July 1997, the Property was assigned to the Taxpayer.
- (7) By provisional agreement for sale and purchase dated 6 August 1997 and agreement for sale and purchase dated 20 August 1997, the Taxpayer agreed to sell the Property at a consideration of \$4,580,000. The sale was subsequently completed on 17 November 1997 when the Property was assigned to the purchaser.
- (8) (a) In her 1997/98 Tax Return, the Taxpayer declared, among others, that her residential address was [at a housing estate in District C] (“[Property 1]”).
- (b) The Taxpayer also declared that she was employed by [Company D] as Officer and that her income for the year ended 31 March 1998 amounted to \$261,350.
- (c) The profit on sale of the Property was not declared in the Tax Return.
- (9) In a questionnaire completed on 18 October 2000, the Taxpayer supplied the following information in respect of the Property:
 - (a) The Property was intended for use as residence of the Taxpayer and her three children.
 - (b) The purchase money came from the money given by [Mr A] to her as a condition of divorce.
 - (c) Subsequently she found difficulty in paying the monthly instalments which amounted to \$38,400. As the market was booming, she sold the Property, hoping that she would repurchase one for self-residence upon an opportune moment.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (d) She invested her monies in the share market. But due to the financial turmoil, she lost all the monies. Although the property market became slack, she was unable to purchase a property for self-residence.
- (e) A computation of profit on sale of the Property as follows:

| | | |
|--|---------------|-----------------------|
| | \$ | \$ |
| Selling price | | 4,580,000 |
| Purchase price | | <u>3,172,275</u> |
| | | 1,407,725 |
| <u>Less:</u> | | |
| Payment made to [Company E] | 310,000 | |
| Commission to agent on sale | 45,800 | |
| Other expenses (estimated due to absence of record) | <u>90,000</u> | <u>445,800</u> |
| Net profit | | <u><u>961,925</u></u> |

- (10) The Assessor was of the view that the profit derived by the Taxpayer from the sale of the Property was chargeable to tax and raised on her the following 1997/98 Profits Tax assessment:

| | |
|---|------------------|
| Profits per the Taxpayer's computation | <u>\$961,925</u> |
| Tax Payable thereon (after deduction of 10% tax rebate) | <u>\$129,859</u> |

- (11) The Taxpayer objected to the above assessment on the ground that the Property was not purchased for resale purpose. She stated the following:
- “
1. At that time, I received a lump sum of moneys from my spouse as a result of the divorce of which I used it as a down payment for the acquisition of [the Property].
 2. Following the divorce, it becomes unlikely for me and my children to continue staying in the same premises with my mother-in-law. After thorough consideration, I have decided to remain because taking the role of a single parent, it is hard for me to afford all the expenses incurring around me.
 3. At the same, I have to rely on my sister's financial support from [Country F] to run my family smoothly besides depending on my monthly fixed earnings.
- ”

INLAND REVENUE BOARD OF REVIEW DECISIONS

4. The proceeds from the disposal have been expended for maintaining regular daily living.
 5. As you can see for the past twenty years, I have no intention to invest in property sector not until I faced the divorce with my spouse.”
- (12) In response to the Assessor’s enquiries, the Taxpayer provided the following information and contention:
- (a) She was separated from [Mr A] in January 1992.
 - (b) [Mr A] paid her \$14,000 per month for the maintenance of the children since the separation, and \$15,000 after the divorce.
 - (c) “Following the divorce, it becomes unlikely for me and my children to continue staying in the same premises ([Property 1]) with my mother-in-law. Therefore I intended to live near my mother who is living in [Housing Estate G in District B] in order to take care of my children by her.”
 - (d) “Although it was unlikely to continue staying in the same premises following my divorce, I have good relationship with my mother-in-law, I could accept to wait for a short period by getting the Occupation Permit on April 1997. Moreover, I preferred to buy a new building rather than a second-hand and also I wanted to live near my mother and sister, therefore the said building was most suitable for me at that time.”
 - (e) “Although I did not want to be divorced since our separation, I have to face it on 1996. At that time I just wanted to get rid of my ex-husband and his family and move out from [Property 1] which I have lived there since my marriage. After reaching an agreement my ex-husband gave me the down payment for the acquisition of [the Property].”
 - (f) “I purchased [the Property] on 24 September 1996 and I divorced on 27 of September 1996, I have already reached an agreement with my ex-husband before the official divorce jurisdiction that he will pay HKD900,000.00 to me as a compensation for the divorce.

HK\$900,000.00 was by “Transfer Deposit” to my [bank account] before September 1996...”

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (g) To finance the purchase of the Property, two instalment loans (“Loan A and Loan B”) were raised from [Bank H] with the following particulars:

| | <u>Loan A</u> | <u>Loan B</u> |
|-------------------------------------|---------------|---------------|
| Lenders: The Taxpayer and [Ms I] | | |
| Amount advanced: | \$2,220,000 | \$320,000 |
| No. of monthly instalments payable: | 360 | 96 |
| Amount of monthly instalments: | \$17,465 | \$4,900 |

- (h) [Ms I] is the sister of the Taxpayer. She did not make any financial support to the Taxpayer. She joined the Taxpayer in applying for Loan A and Loan B because the Taxpayer’s income level was not sufficient for the purpose of the application. [Ms I] promised to support the Taxpayer in case the latter found difficulty in repaying the loans.
- (i) The Taxpayer’s another sister, [Ms J], who was living in [Country F], agreed to give her financial support in paying the monthly instalments.
- (j) The Taxpayer and [Ms J] opened a joint bank account. [Ms J] would deposit money into that account whenever the Taxpayer needed.
- (k) The Property was left vacant because it was still under construction during the Taxpayer’s ownership.
- (l) The Taxpayer found that it was hard for her to take care of her children without the help of her mother-in-law. She also could not afford to pay the expenses that were incurred around her. Besides, she found that it was very difficult for her children to change to other schools. Therefore she decided to remain at [Property 1] and continue to live with her mother-in-law.
- (m) The husband of [Ms J] closed his car repairing business in [Country F] in 1997. As a result, the Taxpayer did not want to rely on [Ms J’s] financial support. This was one of the factors considered by her before disposal of the Property.
- (n) The Taxpayer only received \$20,000 cash from [Ms J]. Due to the latter’s financial hardship, she could not carry out her promise to

INLAND REVENUE BOARD OF REVIEW DECISIONS

support the Taxpayer. [Ms J] stopped supporting the Taxpayer financially in respect of the instalment payments after the Property had been sold.

- (o) In 1996, the Taxpayer's eldest son was a F3 student studying at [Secondary School K]. Her second son was studying F1 at [Secondary School L] and her daughter was a P3 student studying at [Primary School M].
- (p) At the relevant time, she lived with her three children and her mother-in-law at [Property 1]. [Property 1] was owned by her mother-in-law.

(13) The Taxpayer provided the following documents in support of her claim:

- (a) Copy of a letter dated 6 April 2001 (Appendix A) issued by [Ms J] in response to the Assessor's enquiry. The following was stated in the letter:
 - (i) "I only provided cash (HK) \$20,000 to [the Taxpayer] ... I withdrew cash and provided to her during the time I was visiting Hong Kong at the end of 1995."
 - (ii) "Although I promised financial support to [the Taxpayer] when I acknowledged that, she wanted to move out of her mother-in-law's house.

However due to financial hardship with my husband's business, I was no longer able to support her, after she [bought the Property].

Therefore after discussion in depth with our family, we came to the decision that we can no longer support her. It was against our will but it was to the best interest for her to sell the property."

- (b) Copy of a bank account passbook in joint name of the Taxpayer and [Ms J] (Appendix B) showing transactions during the period from 13 January 1993 to 9 September 1997 [see Fact (12)(j) above].

(14) [Ms J] provided a copy of a bank account passbook in her own name (Appendix C). It was marked on the copy that two withdrawals dated 21 and

INLAND REVENUE BOARD OF REVIEW DECISIONS

22 December 1995 in the amounts of \$10,000 each represented funds made to the Taxpayer by her [see Fact (13)(a)(i) above].

- (15) In response to the Assessor's enquiries, [Ms J] asserted the following:
- (a) "I only promised to provide a lump-sum payment of AS\$20,000 – AS\$30,000 to my sister for the purchase of her unit."
 - (b) "My husband owned a car business from January 1993 – 12th July 1999."
 - (c) "The annual after-tax income of my family from 1995 – 1997 was AS\$67,252."
 - (d) "I informed [the Taxpayer] that, I had indeed decided to terminate my decision to support between the period of mid to the end of 1997."
- (16) The Assessor was still of the opinion that the profits derived by the Taxpayer from the sale of the Property were chargeable to Profits Tax and requested the Taxpayer to consider to withdraw the objection. The Taxpayer declined the Assessor's request and contended as follows:
- (a) "As I mentioned before that the acquisition of [the Property] was considered during the most upset and miserable period in my life time and has consequently come up to a quick but incorrect decision which has now put me to a troublesome stage."
 - (b) "Secondly, at that moment, my intention to acquire [the Property] was due to the facts that I want to live apart from my spouse as soon as possible. Unfortunately, shortly after the acquisition, I finally realized that it was beyond my financial control to continue repaying the mortgaged loan with only a limited lump-sum payment as compensation from my ex-husband following the divorce."
 - (c) "Finally, in view of minimizing the financial risks that have had occurred during the short period of my acquisition, I finally accepted my sister's suggestion to dispose the property at the soonest instance."
- (17) In response to the Assessor's further enquiry, the Taxpayer stated the following:

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (a) The sum of \$310,000 allegedly paid to [Company E] as shown in the Taxpayer's computation of profit on sale of the Property [Fact (9)(e)] represented deposit money paid to the development agent of the Property.
 - (b) She decided to sell the Property around the end of August 1997, after she had realized that it was beyond her financial ability to continue repaying the mortgage loan.
 - (c) The gross areas of the Property and [Property 1] were 610 square feet and 675 square feet respectively. They both had two bedrooms.
- (18) The Assessor now considers that the deposit payment of \$310,000 is not allowable for deduction as it has already been included in the purchase cost in computation of the relevant profits. He is now of the opinion that the 1997/98 Profits Tax assessment should be revised as follows:

| | |
|---|------------------|
| | \$ |
| Profits per the Taxpayer's computation | 961,925 |
| <u>Add: Deposit payment</u> | <u>310,000</u> |
| Assessable Profits | <u>1,271,925</u> |
| | |
| Tax Payable thereon (after deduction of 10% tax rebate) | <u>171,709'</u> |

3. As said in paragraph 1 above, by the Determination the Commissioner increased the assessable profits and the tax payable accordingly.

The law

4. 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.'

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

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

INLAND REVENUE BOARD OF REVIEW DECISIONS

6. 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.

7. 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:

'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?'

8. 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 realisable. 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 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.'

The case of the taxpayer

9. The Taxpayer gave sworn evidence in support of her own case. She did not call any other witness.

10. The case of the Taxpayer can be summarised as follows:

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (a) She purchased the Property with a view to using it as a residence for herself and her children because after the divorce with her husband she felt that she could no longer live with her mother-in-law in Property 1.
- (b) She chose to buy the Property because she wanted to live near her mother who was living in Housing Estate G in District B.
- (c) Further, up to the time of her divorce, she had been threatened and harassed on the telephone by her husband's mistress.
- (d) She was expecting to receive financial assistance from her sister in Hong Kong and another sister and her husband in Country F.
- (e) She had to sell the Property eventually because the sister in Country F and her husband could no longer assist her as their business in Country F had suddenly flopped.
- (f) Furthermore, she could not find suitable schools for her children in the vicinity of the Property.

Conclusion

11. Having considered all the evidence, we are not convinced that the Taxpayer acquired the Property with the intention of it being a long term investment.

12. 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. In the present case, the Property was assigned to the Taxpayer on 16 July 1997 and she agreed to sell it by a provisional agreement for sale and purchase dated 6 August 1997 with completion on 17 November 1997.

13. Moreover, with her earnings of about \$18,000 per month in 1996 and alimony from her husband, it is quite obvious that the Taxpayer would have great difficulty in maintaining herself and her children and at the same time make mortgage repayments for the Property over many years. We find the allegation that she was expecting financial assistance from her sisters in Hong Kong and Country F unconvincing, especially when she has adduced no evidence to prove the financial capability of her sisters.

14. We also find her allegation that she could no longer live with her mother-in-law after the divorce to be unconvincing, in light of the fact that she and her children continued to live with her mother-in-law after her separation with her husband in 1992 and had continued to do so even at the date of the hearing of the appeal.

INLAND REVENUE BOARD OF REVIEW DECISIONS

15. As regards the allegation of her trying to avoid interference and harassment by her husband's mistress, the problem would not have been solved by the Taxpayer agreeing to purchase the Property because the development was not to be completed until after April 1997.

16. The most telling feature against the Taxpayer was that she did not appear to have taken her children's schooling seriously into consideration when she agreed to purchase the Property in September 1996. She has not given evidence of what effort or genuine effort she had made in looking for suitable schools for her children if they were really to move from District C to District B.

17. Furthermore, after the Taxpayer had sold the Property and made a profit, she did not use the proceeds to purchase another property as a residence for herself and her children but decided to invest in shares in the stock market. This is hardly supportive of her claim that she purchased the Property for such purpose in the first place.

18. 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.'

19. In order to succeed, the Taxpayer bears the burden of satisfying us on the balance of probabilities that she did have the intention of acquiring the Property for the purpose of a long term investment and not of a trade at the time of such acquisition.

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

21. 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 \$1,271,925 with tax payable in the sum of \$171,709.