

INLAND REVENUE BOARD OF REVIEW DECISIONS

**Case No. D4/92**

Profits tax – sale of property – whether property acquired for residential purposes or for trading purposes.

Panel: William Turnbull (chairman), Felix Chow Fu Kee and Foo Tak Ching.

Dates of hearing: 18 and 19 February 1992.

Date of decision: 9 April 1992.

The taxpayer was an individual who was a property trader. He had purchased a number of flats in different buildings. He had claimed successfully to the assessor that a number of flats had been purchased by him to be used as a family residence. Subsequently the taxpayer purchased two further flats and again claimed that they had been purchased with a view to being his residence. Evidence was given to the effect that the taxpayer had problems with his wife and that he purchased the two flats in question in the hope that she would agree to use them as the family residence. When the wife declined to use the two flats as the family residence the taxpayer sold the same and realized a profit.

Held:

The Board did not accept the evidence of the taxpayer that it was his intention that the two flats should be a family residence. At best the intention of the taxpayer was equivocal in that his intention was to either trade-in the flats or to retain them as a residence. In such circumstances the profit was taxable.

Appeal dismissed.

Case referred to:

Lionel Simmons Properties Ltd (in liquidation) and others v CIR 53 TC 461

Lee Yun Hung for the Commissioner of Inland Revenue.  
Johnny Lau of S Y Leung & Co for the taxpayer.

Decision:

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This is an appeal by a taxpayer against a determination of the Deputy Commissioner wherein he increased the net assessable profits of the Taxpayer for the year of assessment 1987/88 to include the profit made by the Taxpayer on the disposal of certain property. The facts are as follows:

1. The Taxpayer was a property dealer who had described himself in his profits tax returns as carrying on the business of real estate dealing. He had been involved in dealing in properties since earlier than the year of assessment 1972/73. He had registered himself as carrying on business on 11 July 1980 and subsequently claimed to have ceased carrying on business on 1 April 1983, to have recommenced business on 8 June 1985 and to have ceased again on 1 June 1988. From the evidence before the Board it appears that the Taxpayer had been a property dealer throughout the relevant period in question and we find as a fact that he was a property dealer when he acquired the properties which are the subject matter of this appeal, throughout the period during which he owned or had any interest therein, and at the date when he disposed of the same properties.
2. During the years of assessment from 1985/86 to 1987/88, the Taxpayer sold various properties, the particulars of which are as follows:

<u>Sale in Y/A</u>	<u>Property</u>	<u>Date of Purchase</u>	<u>Purchase Price</u> \$	<u>Date of Sale</u>	<u>Selling Price</u> \$	<u>Gross Profit on Sale/ Confirm- ation</u> \$	<u>Date of Issue of Occupat- ion Permit</u>
85/86	Building A						
1	Flat B1, 15/F	+	+	+	+	390) # ) )	
2	Flat B1, 16/F	+	+	+	+	1,500) # ) )	
3	Flat B1, 17/F	+	+	+	+	4,538) # ) )	17-9-85
4	Flat B1, 13/F	3-5-85	291,690	10-10-85	374,000	82,310) )	
5	Flat B2, 13/F	3-5-85	295,830	10-10-85	370,000	74,170)	

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86/87	Building B						
6	Flat A, 14/F	13-7-85	263,026	10-7-86	310,000	46,974)	7-3-86
						)	
7	Flat B, 14/F	13-7-85	261,449	18-10-86	300,000	38,551)	
						)	
87/88	Building C						
8	Flat E, 3/F	3-8-86	365,000	18-1-88	495,000	130,000)	
						)	
9	Flat A, 5/F	3-8-86	381,000	10-12-87	499,000	118,000)	25-11-87
						)	
10	Flat A, 6/F	3-8-86	383,000	4-1-88	480,000	97,000)	
						)	
11	Flat F, 6/F	3-8-86	381,000	5-1-88	500,000	119,000)	
						)	

# : The Taxpayer acted as a confirmor in these transactions

+ : unknown

3. On 18 May 1986 the Taxpayer entered into a sale and purchase agreement in respect of Flats A and B, Building K which was stated to be for residential purposes.
4. The profits realised on the sale of Flats 4 and 5 in 1985/86, 6 and 7 in 1986/87 and 10 and 11 in 1987/88 were not offered for assessment. The representative for the Taxpayer claimed that all these flats had been acquired for residential use. Each pair of flats had been sold because of the refusal of the Taxpayers's wife to move to any of them after actual site inspection.
5. The Taxpayer's residence since 1974 has been Flat 2, Building Y.
6. When the Taxpayer submitted his 1987/88 profits tax return he offered for assessment the profits on disposal of Flats 8 and 9. The assessor was of the opinion that the profits on sale of all properties sold in 1987/88 were assessable and issued an assessment as follows:

\$

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Profit per return	232,049
<u>Add</u> : Estimated profit on sale of Flats A & F, 6/F Building C	<u>200,000</u>
Net Assessable Profit	\$432,049
	=====
Tax thereon	\$71,288
	=====

7. The representative objected against the assessment in the following terms:

‘Our client is aggrieved by your assessment as you have, on 8 March 1990, included the capital gain on disposal of his residential flat as trading income. We are therefore directed to lodge objection on the following grounds:

1. Our client acquired the twin flats (Flats A & F, 6/F Building C) in late 1986 for his proposed new and larger residence. Occupation permit was issued in late 1987. Our client took his wife to have a physical inspection in the new flats, but she refused to move in. Our client was therefore compelled to dispose them in early 1988. Hence it was a capital gain.

Our client request your kindness to refer to the Social Welfare Department, Harbour Building, 38 Pier Road, Hong Kong, [file No. mentioned] regarding the family background especially the mental position of the Taxpayer’s wife and the requirement of a new and larger flat for his family under the advice of the Social Welfare Department.

2. The gain from the disposal was an estimation, and it does not reflect the actual gain. Should it consider necessary, we shall prepare the statement, showing the actual gain on this disposal.’

8. The tax representative subsequently provided a detailed statement of the gain made on the disposal of the properties viz:

### Statement of Disposal

Cost of Building C:	\$	Disposal of Building C:	\$
6/F – A	383,000.00	6/F – A	480,000.00
6/F – F	381,000.00	6/F – F	500,000.00

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Legal fee and etc.	14,288.60	
Surplus on disposal	<u>201,711.40</u>	_____
	980,000.00	980,000.00
	=====	=====

9. The assessor did not accept the representative's contentions that the profits on disposal of properties 10 and 11 were capital gains. In particular the assessor pointed out that the Taxpayer had purchased properties in 1985/86 and 1986/87 which he had said were for residential purposes. In both instances the Taxpayer's wife had refused to move and the resulting profit was claimed as a capital gain. In these circumstances there was nothing to suggest that the Taxpayer's wife would be any more amenable to moving to the premises detailed in fact 2 being Flats 10 and 11. Additionally two flats had been purchased in Building K (fact 3) three months before the purchase of Flats 10 and 11 and the same reason for acquisition had been given that such flats were purchased for residential use. In these circumstances the assessor was of the view that the Flats 10 and 11 were acquired as trading stock and that the profits were correctly chargeable.
  
10. Further submissions and representations were made by the representative and on 22 October 1991 the Deputy Commissioner issued his determination in which he increased the profits tax assessment for the years of assessment 1987/88 from net assessable profits of \$432,049 with tax payable thereon of \$71,288 to assessable profits of \$433,760 with tax payable thereon of \$71,570.

The Taxpayer duly appealed against this determination to the Board of Review.

At the hearing of the appeal the Taxpayer and his three sons were called to give evidence and were cross-examined. The evidence given by the Taxpayer was of limited value and credibility so far as the question which we have to decide is concerned. The question to be decided is, of course, what was the intention of the Taxpayer at the time when he acquired the two flats in question, namely Flats A and F, Building C. There were many inconsistencies in the evidence of the Taxpayer and with the evidence given by his three sons. There was also significant inconsistencies between the evidence of the Taxpayer and the other witnesses who were called on his behalf, a representative of the Social Welfare Department. From the evidence of the five witnesses and submissions made by the representative for the Taxpayer we find the following additional facts:

1. In 1972 or 1973 the Taxpayer agreed to purchase a flat in Building Y which was completed in 1974. The Taxpayer after taking vacant possession in 1974 prepared the premises for use as his residence and moved into Building Y in 1975 with his father and his first two sons. His wife refused to move from the residence then being occupied by the family to the new Building Y. The

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Taxpayer lived apart from his wife for five years from 1975 to 1979, initially with his father and first two sons and subsequently with his three sons. The Taxpayer forced his wife to move into Building Y eventually by locking her out of the original residence which she was still occupying. The Taxpayer and his three sons continued to occupy Building Y as their residence. The wife lived in Building Y from 1979 until her death in 1991.

2. The Taxpayer claimed, and for the purpose of this appeal we accept as a fact, that there was violence between the wife and the Taxpayer after the wife had been forced to move to Building Y. This caused the Taxpayer to fear for his safety at night when he was asleep so that he occupied a separate room in Building Y which could be secured at night against the possible intrusion of his wife. The room occupied by the Taxpayer was shared by two of his sons. His wife occupied on her own the other bedroom in Building Y and the third youngest son slept in the living room.
3. In December 1984 a report was made to the Social Welfare Department with regard to the conduct of the second son of the Taxpayer who had a behaviour and emotional problem.
4. At all material times it was the wish of the Taxpayer and his three sons that they should move from Building Y to a larger residence. In giving evidence the Taxpayer claimed that it was his intention to acquire 'twin flats' that is two flats on the same floor of a building adjacent to each other. We are not able to find this as a fact proved to our satisfaction. The three children when giving evidence referred to their wish that they could live in a larger home but did not appear either to have considered the possibility of having twin flats or to consider having twin flats to be of importance. In this regard we place greater credence upon the evidence of the three children and in particular the youngest who was quite positive in his evidence that the wish or desire was simply to move into a larger apartment. In reaching this decision on the facts we take due note of the fact that the Taxpayer when giving evidence stated that his youngest son shared the Taxpayer's bedroom. However the youngest son in his evidence was quite open and frank in stating that he slept in the living room at that time. Clearly the youngest son was telling the truth and could clearly recollect where he slept.
5. The wife of the Taxpayer died of cancer in February 1991.
6. At the date of the hearing the Taxpayer and his three sons continued to live in Building Y. In addition one flat in Building K (fact 3) had been retained by the Taxpayer and used by his children during the day time for the purpose of pursuing their school studies. The other flat in Building K had been sold by the Taxpayer during the year of assessment 1986/87 but the sale of this flat was not reported to the Inland Revenue Department and any profit on the sale was not

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offered for assessment. The Taxpayer considered the profit not to be taxable on the ground that he had purchased the flat as a residence.

At the hearing of the appeal the Taxpayer was represented by his tax representative and the Commissioner was represented by his representative.

The tax representative for the Taxpayer called a witness from the Social Welfare Department, the Taxpayer, and his three sons. In addition the representative for the Taxpayer and the representative for the Commissioner tabled before the Board a number of documents.

The question for this Board to decide is what was the intention of the Taxpayer when he acquired the two flats in Building C in question. We find against the Taxpayer both on the facts as we have found and even on the facts as he would like us to believe.

Dealing first with the facts as the Taxpayer would like us to accept them we find that the profit is taxable. In essence the case for the Taxpayer is that when he purchased these two flats he did so in the hope that his wife would agree to move to them and live there. He said that the problems which he had with his wife caused difficulties for his children and resulted in one child becoming a juvenile delinquent. He said that the Social Welfare Department had suggested that he should move to a larger residence. Though not suggested by the Social Welfare Department he had decided that it would be appropriate to acquire two adjacent flats one of which could be occupied by his wife and the other of which could be occupied by himself and his three children. During the day time the two flats could be opened and used as one residence but at night time he and his three children could live separately in one flat secure from the possible violence of his wife. He also said that his wife was accustomed to remaining awake late at night and to causing considerable noise and disturbance. The Taxpayer knew that it might be difficult to persuade his wife to move to a new residence and he decided to first purchase one set of twin flats hoping that she would agree to move. When the flats were ready for occupation the Taxpayer took his wife to visit the flats and she declined to move. The Taxpayer then decided to purchase two sets of twin flats and offered them as alternative residences to his wife in the hope that she would choose one set or the other as their future home. When the Taxpayer took his wife to the two sets of residences she again declined to move and he accordingly sold the flats.

As stated we do not accept this version of the facts and reject much of what the Taxpayer would wish us to believe. However even accepting everything which the Taxpayer maintains at its face value we would still dismiss this appeal. The reason is simple. It is well-established law that an asset cannot have an indeterminate status. In the course of making his submission the representative for the Commissioner referred us to the House of Lords decision in Lionel Simmons Properties Ltd (in liquidation) and others v CIR 53 TC 461. Lord Wilberforce said at page 491/492:

‘What I think is not possible is 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. It must be one or other, even

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though, and this seems to me legitimate and intelligible, the company, in whatever character it acquires the asset, may reserve an intention to change its character.’

The Taxpayer said that his intention was to buy two sets of twin flats and to offer them to his wife as alternative residences. He hoped that his wife would choose one or the other but he knew that in the past his wife had rejected all suggestions he had made of moving to a new residence. Though not stated expressly by the Taxpayer or his representative it is clear from the facts that it was the intention of the Taxpayer to sell any twin flats which he had purchased and which were rejected by his wife. Indeed this is a logical and inevitable result of such conduct because the Taxpayer could not indefinitely continue to buy twin flats, offer them to his wife, have them rejected, and retain them as long-term investments. The facts before us show that, with the exception of the flat in Building K retained for the study purposes of the children, the Taxpayer invariably sold the twin flats.

In such circumstances it would not be possible for us to hold that the Taxpayer had decided to acquire the twin flats as the residence of himself and his wife. At best we could only find that he acquired the twin flats hoping that his wife might decide to live in them and with the intention of disposing thereof if she declined to do so. In view of previous experience the Taxpayer must have known that the probability was that his wife would decide not to move to a new residence. In such circumstances we could not find that the two flats in question in Building C were capital assets and we would be obliged to find that they were trading assets and the profit arising on their sale was taxable.

However having heard the evidence of the Taxpayer and the other witnesses called on his behalf and having heard the submissions of his representative we are satisfied that much of what the Taxpayer would like us to believe is fanciful. We have accepted as fact that there were marital problems between the Taxpayer and his wife and that the Taxpayer did have fear for his safety at night. We also have found as a fact that it was the wish of the Taxpayer and his three sons to move into a larger residence. What we do not accept as proved to our satisfaction is that there was any necessity or requirement in the mind of the Taxpayer that the twin flats which he purchased were purchased with the intention that they would be his future residence. The evidence of the children was purely to the effect that they and their father wanted to move to a larger apartment. The Taxpayer was a property dealer and he appears to have specialised in the purchase of new flats when they were uncompleted with the view to selling the same at a profit upon or near completion. He was accustomed to purchasing multiple flats in the same development and in certain cases the flats were adjacent to each other. However it stretches our credulity beyond breaking point to suggest that regardless of whether he could subsequently sell such flats at a profit, he would repeatedly purchase flats to be offered to his wife as a future residence. If such were true it would leave us with many unanswered questions. Apart from the fear that his wife might attack him in the middle of the night we have no evidence to suggest that there was any other family problem. Such evidence as we have suggested that the wife looked after the family and worked in the kitchen. There is nothing to suggest that the Taxpayer and his wife were not on friendly terms during the day. We would have



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thought that in such circumstances the Taxpayer would talk to his wife about the possibility of moving, show her brochures and work with her to find a potential home that she would like. The suggestion that he would go out into the market place, search for and find twin flats which he could in due course offer to his wife, and then suddenly when they are ready for occupation take his wife to inspect them is not something which we can accept on the facts before us.

For the reasons given we dismiss this appeal and confirm the Deputy Commissioner's determination.