

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D5/00

**Profits tax** – acquisition and sale of property – intention at time of purchase – burden of proof on purchaser to establish that property purchased for long term investment – credibility of the taxpayer before the Board – section 68(4) of Inland Revenue Ordinance.

Panel: Robert Wei Wen Nam SC (chairman), Jiang Zhaodong and Stephen Yam Chi Ming.

Date of hearing: 15 September 1999.

Date of decision: 10 May 2000.

The taxpayer (Company A) purchased Property 1 for rental income in June 1991 but sold the same in August 1991 because of its bad geographical location which made letting difficult. The taxpayer argued that such disposal was a change of investment after purchase. Property 2 was purchased in October 1991 and was subject to a two-year tenancy due to expire in March 1992. The taxpayer was unable to find a subsequent tenant after the termination of the tenancy and sold Property 2 in September 1992.

The taxpayer argued that both properties had been purchased with long term investment in mind. Therefore, disposal of both properties was capital in nature and not subject to profits tax for the years of assessment 1991/92 and 1992/93.

#### **Held:**

1. It was for the taxpayer to prove that the acquisition of the properties was for long term investment. A bare assertion was not decisive and must be viewed in the light of the conduct of the parties (Lionel Simmons Properties Ltd (in liquidation) v Commissioner of Inland Revenue 53 TC 461 and All Best Wishes Limited v CIR 3 HKTC 750 followed).
2. As far as intention was concerned, it connoted an ability to carry an act into effect. The taxpayer had to show that he had taken some steps to enable such intention to be implemented (D11/80, IRBRD, vol 1, 374 followed).
3. Regarding Property 1, the quick sale of the property was inconsistent with a long term investment intention. Further, the bad geographical position would have been a factor considered prior to purchase, therefore, this was not decisive. Even though the

## INLAND REVENUE BOARD OF REVIEW DECISIONS

taxpayer had stated that there was a change of investment, this was a mere assertion which was not substantiated by evidence.

4. Regarding Property 2, even though it was purchased with a then-existing tenancy agreement, there was only six months left to run on the tenancy at that time. Further, the quick sale pointed away from the property being a long term investment (D41/91, IRBRD, vol 6, 221 considered).

### **Appeal dismissed.**

Cases referred to:

Lionel Simmons v CIR 53 TC 461  
All Best Wishes Limited v CIR 3 HKTC 750  
D11/80, IRBRD, vol 1, 374  
D41/91, IRBRD, vol 6, 211

Ngan Man Kuen for the Commissioner of Inland Revenue.  
S K Chung of Messrs Raymond S K Chung Co & for the taxpayer.

### **Decision:**

#### **Nature of this appeal**

1. This is an appeal by Company A (the Taxpayer) against the profits tax assessments raised on it for the years of assessment 1991/92 and 1992/93. The Taxpayer contends that the profits derived from the sale of two of its properties (Property 1 and Property 2 respectively) are capital in nature and should not be chargeable to tax.

#### **Agreed facts**

2. The following facts are agreed between the parties:
  - (1) The Taxpayer was incorporated as a private company in Hong Kong on 20 December 1983 under the name of Company A1. By a special resolution dated 20 August 1991, it changed to its present name. At all relevant times, the authorized and issued share capital of the Taxpayer remained at \$200,000 and \$800 respectively. Mr B and his wife, Madam C, are the shareholders and directors of the Taxpayer. Their two sons have also been appointed as

INLAND REVENUE BOARD OF REVIEW DECISIONS

directors of the Taxpayer since 23 June 1992. In its profits tax returns for the years of assessment 1991/92 and 1992/93, the Taxpayer described the nature of its business as ‘ property investing’ and ‘ property investors’ respectively.

- (2) (a) During the year ended 31 December 1990, the Taxpayer owned two properties at Hosing Estate D in District E, with the following details:

<b>Location of property</b>	<b>Purchase date (Purchase price)</b>	<b>Usage</b>
[ ‘ Property 3’ ]	30-9-1998 (\$2,130,000)	Vacant : 30-9-1988 – 14-1-1989 Let out for rental income from 15-1-1989 to 30-12-1989 and from 26-1-1990 to 25-1-1992 at a monthly rental of \$24,000
[ ‘ Property 4’ ]	2-8-1989 (\$2,432,000)	Vacant : 2-8-1989 – 30-9-1989 Let out for rental income from 1-10-1989 to 30-7-1991 at a monthly rental of \$29,000

- (b) The acquisition of Property 3 and Property 4 was partly financed by mortgage loans from banks, as follows:

Property 3 : A mortgage loan of \$1,700,000 from Bank F, repayable by 120 monthly instalments of \$22,877.44 each.

Property 4 : A mortgage loan of \$1,600,000 from Bank G, repayable by 84 monthly instalments of \$26,527.35 each.

- (3) (a) By a provisional agreement dated 6 June 1991, the Taxpayer purchased the property at Housing Estate H [ ‘ Property 1’ ] for \$2,730,000. The purchase was partly supported by a bank loan of \$2,340,000 from Bank F which was repayable by 120 monthly instalments of \$31,574.79 each. Property 1 was assigned in favour of the Taxpayer on 6 July 1991.

- (b) The Taxpayer has produced several receipts amounting to \$32,580 to show that it incurred decoration expenses in relation to Property 1. The receipts showed the following particulars:

<b>Date</b>	<b>Particulars</b>	<b>Amount</b>
		\$

## INLAND REVENUE BOARD OF REVIEW DECISIONS

16-7-1991	Company I - for installation of sun and waterproof floodlight	2,380
19-7-1991	Company J - for gardening works	16,000
24-7-1991	Company K - for floor polishing	2,520
7-8-1991	Company L - for installation of iron gate, window grid and fences	11,680
Total		<u>32,580</u>

In a letter dated 27 September 1993, the Taxpayer's representative stated that the Taxpayer incurred a sum of \$33,580 in the decoration works to Property 1.

- (c) By a provisional agreement dated 1 August 1991, the Taxpayer sold Property 1 for \$3,500,000. The sale was completed on 6 September 1991. The profit of \$559,375 on disposal of the property was shown as an extraordinary item in the Taxpayer's profit and loss account for the year of assessment 1991/92 and not offered for assessment.
- (4) The tenancy agreement for Property 4 was terminated on 1 August 1991. The property had since been laid vacant until its disposal in February 1991.
- (5) By an agreement dated 20 September 1991, the Taxpayer purchased the property at District M [ Property 5 ] for \$1,900,000. The purchase was partly financed by a bank loan of \$1,400,000 from Bank F at an interest rate of 10.5% per annum, repayable by 120 monthly instalments of \$18,890.90 each starting from 30 October 1991. The purchase was completed on 30 September 1991. In October 1991, the Taxpayer entered into a tenancy agreement with a tenant for letting the property for a term of two years from 1 November 1991 to 31 October 1993 at a monthly rental of \$12,000. The property has since been used to derive rental income until its disposal in 1996.
- (6) (a) By a provisional agreement dated 10 October 1991, the Taxpayer acquired another property at Housing Estate D [ Property 2 ] with sitting tenant at a consideration of \$6,700,000. The purchase was partly

## INLAND REVENUE BOARD OF REVIEW DECISIONS

supported by a mortgage loan of \$5,200,000 from Bank F repayable by 180 monthly instalments of \$56,677.45 each. The Taxpayer completed the execution of a legal charge on 22 November 1991 and started repaying the mortgage instalment with effect from 23 December 1991. According to the records of Land Registry, the property was assigned in favour of the Taxpayer on 2 January 1992.

- (b) At the time of purchase, Property 2 was subject to a two-years' tenancy at a monthly rental of \$29,000 which was due to expire on 16 March 1992. On 10 December 1991, the Taxpayer served on the tenant a notice of termination in Form CR101. In response, the tenant notified the Taxpayer that it would not give up possession of the property at the date of termination specified in the notice and that it intended to apply to the Lands Tribunal for the grant of a new tenancy. On 4 March 1992, the Taxpayer through its solicitors offered to enter into a new tenancy agreement with the tenant at a monthly rental of \$45,000 with effect from 17 March 1992. By a letter dated 6 April 1992, the tenant informed the Taxpayer that it would deliver vacant possession of the property and relinquish its tenancy on 15 May 1992.
- (7) By an agreement dated 5 November 1991, the Taxpayer sold Property 3 with the benefit of an existing tenancy for a consideration of \$4,800,000. The sale was completed on 22 November 1991. After consideration of the Taxpayer's reply to his enquiries, the assessor accepted that the profit of \$2,507,862 on disposal of the property was on capital account and not taxable.
- (8) By an agreement dated 12 February 1992, the Taxpayer sold Property 4 for \$5,760,000. The sale was completed on 9 March 1992. After consideration of the Taxpayer's reply to his enquiries, the assessor accepted that the profit of \$2,958,013 on disposal of the property was on capital account and not taxable.
- (9) By a provisional agreement made some time in February 1992, the Taxpayer purchased the property at another property in Hosing Estate D [ ' Property 6 ' ] with sitting tenant at a price of \$7,949,000. The purchase was financed by a bank loan of \$5,000,000 from Bank F which was repayable by 180 monthly instalments of \$49,235.53 each. Property 6 was assigned to the Taxpayer on 1 June 1992. At the time of purchase, the property was let out for monthly rental of \$40,000, the tenancy of which started on 1 January 1992 and was due to expire on 31 December 1993.
- (10) (a) By a provisional agreement dated 26 February 1992, the Taxpayer purchased another property at Housing Estate D [ ' Property 7 ' ] for

## INLAND REVENUE BOARD OF REVIEW DECISIONS

\$8,350,000. Property 7 was assigned to the Taxpayer on 28 July 1992. The purchase was partly financed by a bank loan of 6,800,000 from Bank N, repayable by 216 monthly instalments of \$58,473.47 each starting from 28 August 1992.

- (b) By a tenancy agreement dated 29 July 1992, the Taxpayer agreed to let out the property for a term of two years commencing from 1 August 1992 at a monthly rental of \$51,000. In settlement of a rent dispute caused by the tenant's persistent late payment of rent, the tenant agreed to surrender the tenancy agreement on 1 April 1993 and requested for the grant of a short term tenancy for two months up to 31 May 1993 at a monthly rental of \$51,000. The property was laid vacant during the period from 1 June 1993 to 9 November 1993. On 10 November 1993, the property was let out for a term of one year at a monthly rental of \$49,215. After expiration of the tenancy agreement, Property 7 was occupied by Mr B and his wife as a residence.
- (11) By a provisional agreement dated 6 March 1992, the Taxpayer acquired another property at Housing Estate D [ ' Property 8' ] with sitting tenant at a price of \$8,070,000. The purchase was completed on 30 June 1992 and partly supported by a bank loan of \$5,000,000 from Bank O repayable by 180 monthly instalments of \$49,972.44 each. The existing tenancy agreement was for a term of two years from 1 December 1991 to 30 November 1993 at a monthly rental of \$36,000. The tenancy was renewed for another term of two years from 1 December 1993 to 30 November 1995 at a monthly rental of \$42,000.
- (12) On 16 May 1992, the tenant of Property 2 delivered vacant possession of the property to the Taxpayer.
- (13) By an agreement dated 10 September 1992, the Taxpayer sold Property 2 for a price of \$11,300,000. The profit of \$4,196,570 was classified as ' extraordinary item' in the Taxpayer's profit and loss account and not offered for assessment.
- (14) Accounts submitted by the Taxpayer for the years of assessment 1990/91 to 1992/93 showed the following particulars:
  - (a) The Taxpayer derived the following amounts of rental income from the properties:

INLAND REVENUE BOARD OF REVIEW DECISIONS

	<b>1990/91</b>	<b>1991/92</b>	<b>1992/93</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Property 3 )		256,800	0
)	604,000	[26-1-1991 –	
)		22-11-1991]	
Property 4 )		203,000	0
		[1-1-1991 –	
		30-7-1991]	
Property 1	0	0	0
Property 5	0	12,000	144,000
		[1-12-1991 –	[1-1-1992 –
		31-12-1991]	31-12-1992]
Property 2	0	29,000	140,167
		[17-12-1991 –	[22-11-1991 –
		16-1-1992]	16-12-1991]
			[17-1-1991 –
			16-5-1992]
Property 6	0	0	280,000
			[30-5-1992 –
			31-12-1992]
Property 7	0	0	263,225
			[28-7-1992 –
			31-12-1992]
Property 8	0	0	216,000
			[30-6-1992 –
			31-12-1992]
Total	<u>604,000</u>	<u>500,800</u>	<u>1,043,392</u>

(b) The Taxpayer incurred the following amounts of mortgage interest on the properties:

	<b>1990/91</b>	<b>1991/92</b>	<b>1992/93</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Mortgage interest	<u>341,214</u>	<u>413,983</u>	<u>1,525,761</u>

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (c) The operating results and the assets/liabilities position of the Taxpayer for the years of assessment 1990/91 to 1992/93 were as follows:

	<b>1990/91</b>	<b>1991/92</b>	<b>1992/93</b>
Basis period	31-12-1990	31-12-1991	31-12-1992
<b>Profit and loss account</b>			
	\$	\$	\$
Turnover including rental income	607,016	507,714	1,059,992
	604,000	500,800	1,043,392
Profit (loss) before taxation and extraordinary item	157,042	(136,074)	(892,111)
Extraordinary item	0	3,067,237 ( From sale of Property 3, Property 1)	7,204,055 ( From sale of Property 4, Property 2)
<b>Balance sheet</b>			
Investment properties	4,885,732 ( Property 4, Property 5)	11,642,760 ( Property 4, Property 5, Property 2)	27,292,725 ( Property 5, Property 6, Property 7, Property 8)
Current assets including Director' s current account	45,545	196,965	4,077,228
	0	0	3,879,956
Current liabilities including	2,164,837	2,632,058	1,130,618



INLAND REVENUE BOARD OF REVIEW DECISIONS

Director' s current account	2,046,937	1,106,440	0
Bank loan - current portion	0	1,420,775	795,618
Net current assets/(liabilities)	(2,119,292)	(2,435,093)	2,946,610
Long term liability - bank loan	2,848,565	6,343,132	20,962,658
Financed by :			
Share capital	800	800	800
Retained profit	47,178	2,978,341	9,290,285

- (15) On divers dates, the assessor issued to the Taxpayer the following profits tax assessments:

	<b>1991/92</b>	<b>1992/93</b>
	\$	\$
Loss per return	234,620	1,157,862
<u>Less</u> : Rebuilding allowance overclaimed	76,500	131,345
Interest attributable to finance director' s current account	0	188,659
Gain on disposal of Property 1	559,375	0
Gain on disposal of Property 2	0	4,196,570
Assessable profits	401,255	<u>3,358,712</u>
<u>Less</u> : Loss brought forward for set-off	57,259	
Net assessable profits	<u>343,996</u>	

- (16) The Taxpayer, through its representatives, objected against the above assessments on the grounds that the gains arising from the sale of capital assets should not be subject to tax. Further, the interest expenses was wholly expended in the acquisition of properties and it should be allowable in full.
- (17) By a determination dated 18 May 1999, the Commissioner agreed that the interest expenses should be allowable in full but determined that the profits on sale of Property 1 and Property 2 should be assessable to tax. To give effect to her determination, the profits tax assessment for the year of assessment 1992/93 should be reduced as follows:

\$

## INLAND REVENUE BOARD OF REVIEW DECISIONS

Profits per fact 15	3,358,712
<u>Less</u> : Interest adjustment	<u>188,659</u>
Revised assessable profits	<u><u>3,170,053</u></u>

(18) On 27 May 1999, the Taxpayer through Messrs Raymond S K Chung & Co appealed to the Board of Review.

(19) At all relevant times, the directors, Mr B and Madam C, also derived rental income from two properties located at Housing Estate D with the following particulars:

Year ended	31-3-1991	31-3-1992	31-3-1993
	\$	\$	\$
Location of property :			
(a) Property 9	408,000	416,000	110,600
(b) Property 10	<u>420,000</u>	<u>501,000</u>	<u>528,000</u>
Total	<u><u>828,000</u></u>	<u><u>917,000</u></u>	<u><u>638,600</u></u>

Note :

- Property (a) was acquired in 1985 at \$1,950,000. It was sold on 20 June 1992 for \$8,980,000.
- Property (b) was acquired in 1984 at \$1,355,000. It was sold in 1995 for \$15,600,000.

(20) Mr B has been a medical practitioner since 1980. During the years 1991 to 1993, he derived the following amounts of assessable profits from his practice:

Year ended	<u>31-3-1991</u>	<u>31-3-1992</u>	<u>31-3-1993</u>
Assessable profits	<u>\$406,794</u>	<u>\$470,715</u>	<u>\$461,996</u>

### **Representations by the Taxpayer through its representatives**

3. In reply to enquiries raised by the assessor on 11 August 1993, the Taxpayer's former representatives made the following representations concerning the profit on sale of Properties 1, 2, 3 and 4:

3.1 ' All properties were originally acquired for rental purpose. Property 3 was sold with the existing tenancy for two years expiring on 25 January 1992. Our clients were unsuccessful in letting Property 1 after acquisition. They had to sell the

## INLAND REVENUE BOARD OF REVIEW DECISIONS

property as advised by their estate agent. The fund from sale of Properties 1 and 3 were applied for acquisition of Property 2 and Property 5.'

3.2 ' Property 4 had been held as long term investment for rental income before disposal in 1992 to Company P. Both vendor and purchaser are unrelated and were introduced by estate agent.'

3.3 ' Property 2 was purchased with existing tenancy and the return of investment was low. Our clients were approached by a vendor who proposed to dispose of three properties (Properties 11) as a lot for a total consideration of \$12,000,000. In view of the higher return, our clients disposed of Property 2 for financing the acquisition of Properties 11 at District E. In order to better manage their funds, our Clients acquired other shelf companies to hold Properties 11 in October 1992 and financed the acquisition by applying surplus funds of the Taxpayer and bank loans. These shelf companies are wholly owned by the same shareholders and all are under the common control of same directors of the Taxpayer.'

4. In support of the Taxpayer's objections against the profits tax assessments referred to in paragraph 2(15) and (16) above, its representative reiterated that Properties 1 and 2 were acquired as long-term investments for rental income. The disposal of the properties was prompted by a change of investment. The representatives further asserted the following particulars and arguments:

### Property 1

4.1.1 The Taxpayer purchased Property 1 for rental income. A copy of a resolution passed on 4 June 1991 was forwarded in support.

4.1.2 The Taxpayer agreed to sell Property 1 because the bad geographical position made letting difficult. Property 1 was relatively far away from the town of District E and the yard was back on a road with heavy traffic and noise pollution. Receipts were forwarded in support of the decoration works done to bring Property 1 into a condition fit for being let.

4.1.3 The disposal of Property 1 was a change of investment. Within a very short period of time, the Taxpayer made use of the funds from the sale of Properties 3 and 1 to acquire Properties 5 and 2.

### Property 2

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- 4.2.1 The Taxpayer purchased Property 2 [on October 1991] with an existing tenancy agreement which would expire on 16 March 1992. A copy of a resolution passed on 8 October 1991 was forwarded in support.
- 4.2.2 The Taxpayer offered but the tenant did not accept a new tenancy agreement at a new rental of \$45,000 per month which was about the prevailing market rent. The employee of the tenant occupying the property informed the Taxpayer that he was not entitled to a quarter with a monthly rent of \$45,000. The lease was extended for two months and the tenant delivered vacant possession of Property 2 to the Taxpayer on 15 May 1992. In spite of the listing for letting given to property agents, Property 2 could not be let out.
- 4.2.3 Property 2 was sold [on 10 September 1992] to provide funds to the Taxpayer to acquire other properties at Housing Estate D in the year ended 31 December 1992 and to embark on a property project in China. A copy of a resolution passed on 22 August 1992 was forwarded in support.
- 4.2.4 An agreement related to the above-mentioned property project was made in February 1993 but visits to China, negotiations etc took place long before that time. The project was subsequently taken up by Mr B personally. The agreement together with a translation thereof was adduced by the representatives. It reads as follows:

Contract to assign the right of use in land

‘ Party A : Company Q  
Party B : Company A

Both parties shall on the basis of their own free will, equality, mutual benefits and compliance with the law sign this Contract in assigning the right of use in Lot R in Island S by Party A to Party B. Both parties shall observe the following:

1. Party A shall obtain the right of use in Lot R in Island S which has a total area of 30 acres and shall assign it to Party B for use (for actual location see the red-line map of Island S s Land Department) as commercial-cum-residential complex.
2. The lease shall be for term of years as provided by the law of PRC (the lease shall start to run according to the time set by Land Department). Upon expiry, renewal shall be in accordance with national regulations.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

3. Both sides agree that Party B shall pay Party A at RMB\$152,000 per acre a total of 30 acres and total amount of RMB\$4,560,000 (including compensation for grass, fruits, trees and labour, fees for assigning land). Party B shall obtain 30 acres of loan (location is at Lot R). It shall be divided up into 100 acres and shall be classified by random.
4. Method of payment. Party B shall pay 40% of the total cost of land within 9 days of the signing of this Contract which is about one million eight hundred twenty thousand RMB a deposit. The balance of RMB\$2,720,000 shall be paid within six months (for details please see schedule).
5. Party A shall be responsible for applying for land use licence and boundary map, handle disputes arising from land use and ownership of land. Party A shall be given land use licence and boundary map within two months of payment of the balance and confirm Party B' s right of use in land.
6. Default : Unless for reasons of changes in law or force majeure, Party A have to compensate Party B all the monies paid by plus interest (monthly 1.99%) and losses suffered by Party B by 30 October 1993 and shoulder all responsibilities and terminate this Contract if Party A defaults. If Party A defaults. If Party B breaches the Contract, Party A shall cancel all the payments by Party B and compensate Party A for all the losses and shoulder all responsibilities and terminate this Contract.
7. The Contract shall take effect for the day both parties sign this Contract. Both parties shall perform this Contract and should not raise new clauses.
8. The Contract in quadruplicate. Each party shall hold two copies.

Signed by representative of Party A. Signed by representatives of Party B.

Date February 1993.

Payment schedule

## INLAND REVENUE BOARD OF REVIEW DECISIONS

<b>Date of payment</b>	<b>Amount paid RMB\$</b>
March 1993	1,820,000
April 1993	460,000
May 1993	460,000
June 1993	460,000
July 1993	460,000
August 1993	460,000
September 1993	440,000

Note: Payment by the 10<sup>th</sup> each month.'

- 4.2.5 ' Given the protections extended to a tenant under the Landlord and Tenant (Consolidation) Ordinance and as a prudent commercial decision, we believe that a reasonable person will not acquire a property with an existing tenancy agreement as trading stock.'

Generally, the representatives contended:

- ' Property 2 was not sold merely for an expectation of a higher return on an investment. The Taxpayer believed that the former representatives might have mixed up its commercial decisions with those of its three related companies. The disposal of Properties 1 and 2 was prompted by a change of investments. The Taxpayer needed a large sum of money for its property project in China, let alone the cash drain caused by the abortive attempt to let out the properties.'

The representatives further advised that the Taxpayer did not make a written agreement with any particular property agent when it was prepared to sell or to let out a property and therefore there was no documentary evidence in support of the efforts made to let out the properties concerned.

### **The hearing and the parties**

5. This appeal was heard on 15 September 1999. The Taxpayer as represented by its representatives Messrs Raymond SK Chung & Co, tax consultants, while the Commissioner of Inland Revenue was represented by Miss Ngan Man-kuen. At the beginning of the hearing, Mr SK Chung, the principal of Messrs Raymond SK Chung & Co, informed the Board that Mr B, the controlling shareholder and director of the Taxpayer, would not be called as a witness for personal reasons, that is, that Mr B had to leave for Beijing the next day to attend to some litigation there. Although he was in Hong Kong now, he had a lot of preparation to do for the litigation in Beijing.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

The decision made was not to call any witness. Mr B had informed him unexpectedly on the 13<sup>th</sup> that he was not prepared to attend the hearing of this appeal.

### The law

6. The following legal principles are applied in this case:

- 6.1 ‘ *Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the 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?’ (per Lord Wilberforce in Lionel Simmons v CIR 53 TC 461 at 491.)*
- 6.2 ‘ *Often it is necessary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss.’ (per Lord Wilberforce, *ibid.*)*
- 6.3 ‘ *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 ...’ (per Lord Wilberforce in Simmons’ case at 492.)*
- 6.4 ‘ *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 ... 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 Limited v CIR 3 HKTC 750 at 771.)*
- 6.5 ‘ *“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 at 379.)*

## INLAND REVENUE BOARD OF REVIEW DECISIONS

6.6 *The onus of proving that the assessment appealed against is excessive or incorrect shall be on the Taxpayer. (Section 68(4) of the Inland Revenue Ordinance(‘IRO’), chapter 112.)*

### **Findings and reasons**

7. In his opening, Mr Chung stated that Mr B and/or his wife, during 1976 to 1995, had the experience of purchasing, holding and selling, in their own names, some six properties located in three different districts, one of which was District E; some were used for producing rental income and others for residential purposes. They sold these properties, one after the other, after holding them for some two to ten years. Miss Ngan did not challenge Mr Chung’s statement, and we will, for the purposes of this case, accept it.

8. Of the eight properties held by the Taxpayer, we are concerned with two, Property 1 and Property 2. The question in respect of each of these two properties is identical : in purchasing the property, did the Taxpayer or its directing mind Mr B intend to hold it as a long-term investment for rental income? The Taxpayer says yes and it is for the Taxpayer to prove it.

### **Property 1**

9. The Taxpayer adduced the minutes of a directors’ meeting presided over by Mr B as chairman and held on 4 June 1991, at which it was resolved that the Taxpayer agreed to purchase Property 1 for \$2,730,000 and to charge/mortgage the property to a named bank to secure general banking facilities to the extent of \$2,340,000 and that the Taxpayer should hold the property as a long-term investment for rental income. This declaration of intention contained in the board minute is not sufficient evidence of a long-term-investment intention. It has to be judged by considering the whole of the surrounding circumstances, or, as it is sometimes phrased, tested against objective facts (see paragraph 6.4 above).

#### The quick sale

10. Property 1 was purchased on 6 June 1991, assigned to the Taxpayer on 6 July 1991 and sold on 1 August 1991 (see paragraph 3(a) and (c) above). Needless to say, the quick sale is inconsistent with any long-term-investment intention, and, unless it is satisfactorily explained away, the long-term-investment intention cannot be proved.

11. The Taxpayer’s explanation consisted mainly of two parts:

11.1 Property 1 was sold because bad geographical position made letting difficult.  
The property was relatively far away from the town of District E and the yard



## INLAND REVENUE BOARD OF REVIEW DECISIONS

was on a road with heavy traffic and noise pollution (see paragraph 4.1.2 above). This will be referred to as the geographical-position explanation.

11.2 The disposal of Property 1 was a change of investment. Within a very short period of time, the Taxpayer used the funds from the sale of Properties 3 and 1 to acquire Properties 5 and 2 (see paragraph 4.1.3 above). This will be referred to as the change-of-investment explanation.

### Geographical-position explanation

12. As Miss Ngan pointed out, Mr B was not a ‘first-time property investor’ when he decided to acquire Property 1 for the Taxpayer : he had purchased, in his own name or otherwise, some eight properties (including Property 3 and Property 4). Location is a crucial factor because on it depends the rate of return which the property commands. As an experienced investor, Mr B would have carefully considered this factor before deciding to purchase Property 1 for rental income. It is not the Taxpayer’s case (nor is there any evidence to show) that the Taxpayer or Mr B did not know or consider this factor before the purchase. Miss Ngan submitted that the geographical-position explanation is not credible. We agree.

13. At an earlier point in time in the objection stage, the Taxpayer’s former representatives, in answering the assessor’s inquiries, had stated that ‘Our clients were unsuccessful in letting Property 1 after acquisition. They had to sell the property as advised by their estate agent (see paragraph 3.1 above).’ This would make the geographical-position explanation an afterthought, and so we find.

14. Taking the ‘unsuccessful in letting’ explanation by itself, it is an explanation deficient in particulars showing how intensively and extensively and by what methods the property was advertised for letting, and what was the nature of the advice of the estate agent upon which the Taxpayer acted by selling Property 1. Mr B and the leading estate agents would have been key witnesses, but none of them was called. Such a vague explanation can hardly remove the inconsistency of the quick sale from the Taxpayer’s case of a long-term-investment intention.

15. Furthermore, Property 1 was assigned to the Taxpayer on 6 July 1991 and sold by the Taxpayer on 1 August 1991. The speed of the sale hardly left any realistic period for advertising for letting, and this can be demonstrated by referring to the fact that Property 3 and Property 4 were laid vacant for three-and-a-half months and two months respectively before they were successfully let out (see paragraph 2(2)(a) above).

16. It is said that the decoration works were done with a view to facilitating the letting out of Property 1. Miss Ngan submitted that they could equally serve to enhance the attractiveness and value of the property in a resale.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Change-of-investment explanation

17. Lord Wilberforce stated in Simmons' case (see paragraph 6.2 above) that 'a permanent investment may be sold in order to acquire another investment thought to be more satisfactory ...' The scenario is this : an investor who has invested in a long-term investment now thinks that another property would be a more satisfactory investment, so he sells the existing investment and applies the proceeds of sale to acquire the other property as his new long-term investment. The scenario requires an existing long-term investment which is subsequently sold and replaced by the acquisition of a new, more satisfactory long-term investment.

18. The Taxpayer's case rests on a mere assertion that the disposal of Property 1 was a change of investment. This implies that Property 1 was a long-term investment which was replaced by some other long-term investment or investments. To start with, the Taxpayer must prove that Property 1 was a long-term investment. The mere assertion that that is so is not proof. Nor is the fact that the proceeds of sale of Property 1 were applied in the acquisition of other assets as long-term investments, because that fact is equally consistent with Property 1 being acquired as a trading asset or as a long-term investment. Here we agree with Miss Ngan's submission that there is nothing to preclude a trader from utilising his proceeds of sale to acquire another asset, capital or otherwise.

19. For the above reasons, the Taxpayer has failed to prove its case of a long-term-investment intention to towards Property 1.

### **Property 2**

20. Like Property 1, there are minutes of a board meeting (dated 8 October 1991) declaring a long-term-investment intention towards Property 2 which was purchased by the Taxpayer on 10 October 1991. The minutes are in similar form to those relating to the purchase of Property 1. For similar reasons, we take the view that the declared intention should be tested against the objective facts (see paragraph 9 above).

### The quick sale

21. Property 2 was purchased on 10 October 1991 subject to a two-year tenancy at a monthly rental of \$29,000 due to expire on 16 March 1992. The Taxpayer offered but the tenant did not accept a new tenancy at a monthly rental of \$45,000 which was about the prevailing market rent. The tenant delivered vacant possession of the property to the Taxpayer on 15 May 1992. The Taxpayer sold Property 2 on 10 September 1992 (see paragraph 2(6)(a)-(b), 2(12)-(13), and 4.2.1-3 above).

22. The board minutes stated that the Taxpayer should purchase the property as a long-term investment for rental income. But the Taxpayer sold it within four months of delivery of vacant

## INLAND REVENUE BOARD OF REVIEW DECISIONS

possession. The sale is inconsistent with the declared long-term-investment intention and has to be explained away.

23. There is an assertion that in spite of the listing for letting given to property agents, Property 2 could not be let out (see paragraph 4.2.2 above). But there is no assertion, let alone evidence, that the Taxpayer's failure to secure a tenant was the reason or one of the reasons for the sale. Even assuming (without finding) that an assertion can be inferred from the circumstances that failure to find a tenant was the or a reason for the sale, still the explanation will remain a mere assertion unsupported by evidence and more particularly by testimony of Mr B and the property agents. Furthermore, it will still be vague and deficient in particulars, so much so that the inconsistency of the sale will still be there.

### The change-of-investment explanation

24. In our view, the only explanation offered by the Taxpayer was that Property 2 was sold in order to acquire other investments. In other words, it was a change of investments. Here we revert to what we stated in paragraphs 17 and 18 above and point out that the mere sale of Property 2 to finance the acquisition of some assets as long-term investment does not of itself prove that Property 2 was a long-term investment; that has to be proved by other independent evidence.

25. There are two versions of the change-of-investment explanation. As pointed out by Miss Ngan, the Taxpayer initially asserted that Property 2 was sold for a switch of investment to properties Properties 11. Later it changed its case by asserting that the sale was caused by a need of funds to finance the purchase of other properties at Housing Estate D (and it is not in dispute that those properties at Housing Estate D were Property 6, Property 7 and Property 8) as well as a property project in China. The replacement of the first version by the second introduces a large measure of uncertainty into both versions and deals a severe blow to the credibility of the explanation.

26. We have before us the minutes, dated 22 August 1992, of a board meeting recording the following:

‘ It was resolved that in view of the short-term and contingent liabilities arising from the acquisition of additional properties as long-term investments by the Taxpayer and its decision to embark on a property development project in China, the Taxpayer agreed to sell [Property 2] to the buyer for a consideration of HK\$11,300,000 for the purpose of raising funds.’

27. The board minutes do not identify the ‘ additional properties’ nor mention Property 6, Property 7 and Property 8. The Taxpayer had completed the purchase of Property 6, Property 7 and Property 8 by 1 June, 28 July and 30 June 1992 respectively, that is, about one to three months

## INLAND REVENUE BOARD OF REVIEW DECISIONS

before 10 September 1992, the date when Property 2 was sold. We are not satisfied on the evidence that Property 2 was sold to acquire those three properties.

28. The Taxpayer also claimed that negotiations relating to the property project in China had been going on for some time and that the quest for funds to finance the project was one of the reasons for the sale of Property 2. There was no information about the business set up in China, nor any evidence (apart from the board minutes mentioned in paragraph 26 above) to show that Property 2 was sold to meet a call for funds to finance the acquisition of the property project. The agreement between the Taxpayer and the Chinese company (see paragraph 4.2.4 above) was made in February 1993 and monthly instalment payments would only start in March 1993, while Property 2 was sold in September 1992. The board minutes do not show why Property 2 had to be sold to raise funds for the project when there was as yet no agreement for the project, let alone any need for funds.

29. In fact the Taxpayer did not proceed with its investment in the project in China; it asserted that the project was subsequently taken up by Mr B personally (see paragraph 4.2.4 above).

30. In our view the Taxpayer's explanations have failed to remove the inconsistency between the asserted long-term-investment intention towards Property 1 and Property 2 and the quick sale of two properties.

### Sitting tenant - whether a factor in favour of a long-term-investment intention

31. The Taxpayer argued that no reasonable man would have acquired a property with an existing tenancy agreement as trading stock (see paragraph 4.2.5 above). Miss Ngan cited the following statement in D41/91, IRBRD, vol 6, 211 at 215:

*‘ Generally speaking, a trader would prefer to resell with vacant possession, but this does not mean that, given the right circumstances, a trader would not purchase a tenanted flat.’*

At the time of the purchase of Property 2, the existing two-year tenancy was due to expire in six months' time. The existing rental was \$29,000 per month, while the prevailing market rent was \$49,000 per month. Owing to the expected sharp increase in rent, the value of the property would also be expected to rise. We accepted Miss Ngan's submission that these circumstances show that Property 2 was a good target for trading purpose.

### Conclusion

## INLAND REVENUE BOARD OF REVIEW DECISIONS

32. We are not satisfied in all the circumstances of this case that in acquiring the two subject properties the Taxpayer intended to hold them as long-term investments for rental income, and we go further and find that the Taxpayer acquired them for trading purposes.

33. It follows that this appeal is dismissed and that the profits tax assessment for the year of assessment 1991/92 as per paragraph 2(15) above and the profits tax assessment for the year of assessment 1992/93 as reduced as per paragraph 2(17) above are hereby confirmed.