

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D50/92

Profits tax – whether property capital asset or trading stock – onus of proof.

Panel: T J Gregory (chairman), Joseph S Brooker and Michael A Olesnicky.

Dates of hearing: 10 November and 10 December 1992.

Date of decision: 3 February 1993.

The taxpayer was a private limited company owned by a solicitor who claimed that certain property purchased by the company was a long term capital asset and that there had been a change of intention. The solicitor gave evidence and was cross examined.

Held:

Having heard the evidence given on behalf of the taxpayer and having reviewed the facts before it the Board held that the taxpayer had not discharged the onus of proof placed upon it. The assessment was confirmed.

Appeal dismissed.

Cases referred to:

Simmons v IRC 55 TC 461
D61/88, IRBRD, vol 4, 62
D62/88, IRBRD, vol 4, 65
Turner v Last 42 TC 517

Iris Ng for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

1. THE SUBJECT MATTER OF THE APPEAL

- 1.1 The Taxpayer objected to the second additional profits tax assessment raised on it in respect of the 1988/89 year of assessment.

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- 1.2 The ground of appeal was that the profit sought to be taxed by this second additional assessment was a capital gain, namely the profit arising on the sale of a certain real estate (hereinafter the 'X Property'), refer paragraph 3.6 below, which had been acquired and held as an investment asset and, accordingly, was not subject to profits tax.

2. PRELIMINARY POINT

- 2.1 In a manuscript letter dated 1 December 1992 addressed to the assessor (appeals) by the Taxpayer, and signed by the director and shareholder, a practicing solicitor, who was to appear at the appeal as its representative and witness, 'Mr A', a copy of which was provided to the Board, the assessor (appeals) was informed, inter alia, that:

- 2.1.1 '(a) "Mr A" is the doer of the Act (that is the property transaction in question) and not the company.'
- 2.1.2 '(b) the company was used as a vehicle of convenience – that is it took part notionally.'
- 2.1.3 '(c) the company did not put up any part of the purchase price.'
- 2.1.4 '(d) the company did not receive any part of the sales proceeds.'
- 2.1.5 '(e) the company would not have taken even a notional part had I not considered it prudent to avoid any conflict of interest in that I acted as a solicitor in the transaction also.'

- 2.2 At the commencement of the appeal Mr A, in answer to questions from the Board:

- 2.2.1 Confirmed that the Taxpayer's ground of appeal was that the profit in question was a gain arising on the disposal of an investment and not from a trading venture.

- 2.2.2 Denied that he had not suggested to the officer of the Inland Revenue Department ('IRD') who had interviewed him on 30 August 1991, refer paragraphs 4.6 and 5.1.2 below, that the Taxpayer had acted as an agent for him as principal and referred the Board to the following passages in the IRD's note of that interview, a copy of which was before the Board:

'He used the company as a vehicle for dealing with his business activities as it might be more convenient.'

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He used the company to purchase the subject property instead of by himself was to avoid conflict of interest in dealing with legal matters and signing assignment since, he himself was a solicitor.’

- 2.2.3 Having been referred to the five sub-paragraphs from the letter of 1 December 1992 quoted in paragraph 2.2.1 above and asked whether those indicated that the Taxpayer was an agent or trustee stated that he had explained everything to the interviewing officer fully but that this had been ignored. The paragraphs in question were for emphasis.
- 2.2.4 Confirmed that he had signed the Taxpayer’s audited accounts for its year ended 31 March 1989.
- 2.2.5 Confirmed that those audited accounts showed that the transaction was a transaction of the Taxpayer but referred the Board to the copies of two letters dated, respectively, 29 July 1991 and 19 November 1991, the former having been addressed to the Taxpayer before the interview of 30 August 1991, refer paragraph 2.2.2 above, and the latter subsequent to that interview.
- 2.2.6 When asked why no reply to the letter dated 19 November 1991 had been addressed by the Taxpayer to the IRD, the Taxpayer referred the Board to the last paragraph of the note of that interview, which reads:

‘ After the long discussion I [the interviewing officer] advised him [Mr A] that I would first check some of his history of property transaction first and would ring him later to see whether any questions have to be asked before he sent in his written reply.’

and added that he had thought he had answered the questions at the interview, that he had not been telephoned by the IRD, as stated at the end of the interview, and that he did not have much of the written evidence the IRD wanted.

- 2.2.7 Confirmed that the Taxpayer was the principal in the property transaction in question.

3. FACTS NOT IN DISPUTE

The following facts were not in dispute:

- 3.1 The Taxpayer was incorporated in Hong Kong in early 1982. At all relevant times Mr A and his wife [named] (hereinafter ‘Mrs A’) were the only shareholders and directors of the Taxpayer.

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- 3.2 Mr A is a solicitor and has been carrying on his professional practice under the name [name stated] (hereinafter the 'Firm'). The Taxpayer has provided office space and equipment to the Firm and has received a management fee in return.
- 3.3 On 24 March 1975, being the date of the assignment to them, Mr A and Mrs A became the legal owners of an apartment situated at Place A at a cost of \$341,452 which they then used as their residence (hereinafter the 'Old Residence'). The date of the assignment on their sale of the Old Residence is 28 July 1988.
- 3.4 On 4 August 1979, being the date of the assignment to her, Mrs A became the legal owner of an apartment at Place B (hereinafter the 'B Property'). The date of the assignment on her sale of this property is 20 May 1987 and the sale price was \$698,000.
- 3.5 On 8 April 1980, being the date of the assignment to them, Mr A and Mrs A became the legal owners of an apartment at Place C, (hereinafter the 'C Property'). The date of the assignment on their sale of this property is 30 May 1987 and the sale price was \$850,000.
- 3.6 By an agreement for sale and purchase dated 16 May 1988 the Taxpayer contracted to purchase the X Property at a cost of \$4,800,000. At the time of this agreement, a building providing domestic units was under construction. The individual units were assigned to purchasers after issuance of the Occupation Permit, the Taxpayer joining in the assignments as Confirmor.
- 3.7 On 28 July 1988, being the date of the assignment to her, Mrs A became the legal owner of a shop in a block in Place B at a cost of \$823,000 (hereinafter the 'B Shop'). This property was still owned by Mrs A at the date of the hearing of the appeal. The purchase price was paid on 3 March 1988, refer paragraph 5.1.6 below and Exhibit 'AT-5'.
- 3.8 On 8 September 1988, being the date of the assignment to it, the Taxpayer became the legal owner of an apartment and the roof over that apartment in the same block at Place B as the Old Residence (hereinafter the 'New Residence'). The purchase price was \$3,990,000 and was paid in full on 27 April 1988, refer paragraph 5.1.5.3 below and Exhibits AT-3 and AT-4. Since acquisition the New Residence has been provided by the Taxpayer to Mr A and Mrs A as 'directors' quarters'. This property was still owned by the Taxpayer at the date of the hearing of the appeal.
- 3.9 On 2 March 1989, being the date of the assignment to her, Mrs A became the legal owner of a shop in a block in Place E at a cost of \$2,700,000 (hereinafter the 'E Shop'). Mr A had contracted to purchase this property in January 1989 but nominated Mrs A as the assignee. This property was still owned by Mrs A at the date of the hearing of the appeal.

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- 3.10 On 24 April 1989, being the date of the assignment to him, Mr A became the legal owner of an apartment in a block in Place F at a price of \$1,000,000 (hereinafter the 'F Property'). The date of the assignment on the sale of this property was not provided.

4. FINDING OF ADDITIONAL FACTS

The Board finds as fact the following:

- 4.1 In the absence of a profits tax return for the year of assessment 1988/89 the assessor raised two estimated profits tax assessments:

	<u>1988/89 Assessment</u>	<u>1988/89 Additional Assessment</u>
Date of Issue	22 November 1989	26 April 1990
Estimated Assess- able Profits	<u>\$200,000</u>	<u>\$250,000</u>
Tax Payable thereon	<u>\$34,000</u>	<u>\$42,500</u>

- 4.2 No objections were lodged by or on behalf of the Taxpayer with respect to those assessments.

- 4.3 The Taxpayer's profits tax return for the year of assessment 1988/89 together with its audited accounts together with tax computation for the year ended 31 March 1989 although dated 30 September 1990 was received by the Revenue on 19 December 1990. The return disclosed assessable profits of \$458,943 and the profits tax computation included an exceptional gain of \$1,072,304 made on disposal of property, namely the X Property, which profit was not offered for assessment. Copies of the return and audited accounts profits tax computation with its supporting schedules were before the Board.

- 4.4 On 14 January 1991 the assessor wrote to the Taxpayer's auditors who had been notified as its representative in the return, requesting additional information with respect to the disposal of the X Property. A copy of this letter was before the Board. No reply was received to that letter.

- 4.5 On the 16 May 1991 the assessor raised a second additional profits tax assessment for the year of assessment 1988/89 as follows:

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	\$
Profits per Return	458,943
Add: Gain on disposal of Properties	<u>1,072,304</u>
	1,531,247
Less: Profits already assessed	<u>450,000</u>
	<u>\$1,081,247</u>
Tax Payable thereon	<u>\$183,811</u>

4.6 The Taxpayer's representative objected to this second additional assessment putting forward the following objections:

- ' (a) that your aforesaid assessment is incorrect;
- (b) that the gain on disposal of property is of capital nature not subject to profits tax; and
- (c) that the information under reply is given in a separate cover for your consideration.'

4.7 On 29 July 1991 the assessor wrote to the Taxpayer requesting additional information, a copy of which letter was before the Board. No reply was given to this letter.

4.8 On the 30 August 1991 the assessor interviewed 'Mr A' who, in his capacity as a director, had signed the Taxpayer's audited accounts and its tax return. A copy of the notes of the interview was before the Board.

4.9 On 19 November 1991 the assessor issued a formal notice to the Taxpayer to furnish information concerning the disposal of the X Property. A copy of this notice was before the Board. No reply was received to that notification.

4.10 The Taxpayer's representative's objection to the second additional assessment was referred to the Commissioner who issued his determination on 23 July 1992, a copy of which was before the Board. The Commissioner confirmed the second additional assessment and his reasons therefor were that neither the Taxpayer nor its representative had provided the documents and information requested by the assessor.

5. CASE FOR THE TAXPAYER

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Having sworn in English Mr A gave evidence. His evidence may be summarised as follows:

5.1 In chief:

5.1.1 The Taxpayer:

5.1.1.1 At all material times he has been a director of the Taxpayer and his evidence was given on behalf of the Taxpayer.

5.1.1.2 The Taxpayer was incorporated in early 1982. It was purchased by the Taxpayer from its incorporators and as soon as he had acquired the company he had changed the name to its present name. Initially he had been the sole shareholder but subsequently his wife had become a shareholder. At all material times he and his wife, Mrs A, were the sole directors and shareholders.

5.1.1.3 So far as the Taxpayer was concerned, he could do what he liked with the Taxpayer. He and Mrs A consulted on all investments they were considering, and whether individually or jointly, and only proceeded when they were in agreement.

5.1.1.4 He had used the Taxpayer to purchase the X Property to avoid any conflict of interest.

5.1.2 His interview with the IRD on 30 August 1991:

5.1.2.1 Having received the letter dated 29 July 1991, refer paragraph 4.7 above, he went to the IRD. He referred the Board to the note of the interview of 30 August 1991, refer paragraph 4.8 above, and proceeded to take the Board through the note of the interview and, occasionally, gave information additional to that recorded.

5.1.2.2 He had given the Revenue the history of his, his wife's and their joint property transactions, refer paragraphs 3.3 to 3.10 above, to establish that neither he nor his wife, individually or collectively, was a trader in property. He also provided the Board with the sale prices of the B Property and the C Property noted in paragraphs 3.4 and 3.5 above.

5.1.3 The Old Residence, the B Property and the C Property:

5.1.3.1 In 1979 he and his wife were living in the Old Residence. However, having decided to go to Country X to complete his examination, he had leased the Old Residence. Later, his plan to go to Country X was abandoned but his approach to the tenant of the Old Residence to surrender the tenancy was rejected. Accordingly, the B Property was purchased for a family residence. Later, the C

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Property was purchased as it was a better residence and he and his wife moved there and let the B Property.

5.1.3.2 Possession of the Old Residence was recovered in 1982 or 1983 so they returned to the Old Residence and let the C Property.

5.1.3.3 In the late 1987, before the October Stock Market crash, he sold the B Property and C Property. These sales were not motivated by an anticipation of the Stock Market crash but because he and his wife thought other investments would be better. Having sold these two properties the only property owned by himself and his wife was the Old Residence.

5.1.4 The X Property:

5.1.4.1 In January 1988 an estate agent, who was a personal friend, approached him and offered him the X Property. On its completion the building on the site, which was then under construction, would contain units totalling some six thousand square feet. There was no vehicular access.

5.1.4.2 At the time he agreed to purchase he thought that it was time to add properties to his investment portfolio. He had never purchased real estate unless for personal accommodation or for investment. The price for the property was low and it was his habit to purchase when prices were low and he could see a long-term future growth. Also, at this time the Hang Seng index was at an historical low.

5.1.4.3 In the early part of 1988 interest rates were very low and his projection of the rental income was that this would exceed interest on the capital involved.

5.1.4.4 The decision to purchase this property was not a hasty decision. About three months elapsed between him being first approached with the offer and making a verbal commitment and his decision to purchase. He added that he had deferred both paying the initial deposit of \$300,000 and returning the sale and purchase agreement with the monies for the balance of the deposit until the last possible minute.

5.1.4.5 This was the first time he had purchased an entire block. To purchase the property he had to pay \$300,000 as an initial deposit and to bring that deposit up to \$1,440,000 when the sale and purchase agreement was exchanged. The balance of the purchase price had to be paid on the issuance of the Occupation Permit.

5.1.4.6 The monies paid to purchase this property were paid out of his own available cash. He produced an application to Bank K for the issuance of a cashier order for \$300,000 which he stated was for the initial payment of \$300,000. He identified his signature on the application. A certified true copy of this application was admitted as an exhibit and marked 'Exhibit At-1'. He also

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produced a receipt dated 23 April 1988 for the sum of \$300,000 the payee being identified as the Firm and which \$300,000 was expressed to be 'earnest money for the intended purchase, subject to contract, in respect of the above property', which was identified as the X Property. A copy of this receipt was admitted as an exhibit and marked 'Exhibit AT-2'.

- 5.1.4.7 He explained his reasons for purchasing the property. He said he was toying with the idea of renting the units on short term lets to visitors from Place Y and Place Z. He thought that the return would be between 9% and 10% and that this return would be nett, as opposed to gross, and way in advance of a return from interest on bank deposits.
- 5.1.4.8 Although his memory was that there had been a suitable minute on behalf of the Taxpayer, he had been unable to locate the minute either before his interview with the Revenue or between that interview and the date of the hearing of the appeal.
- 5.1.5 The New Residence:
- 5.1.5.1 Within days of his payment of the \$300,000 for the X Property he became aware that the apartment which was to become the New Residence was on offer for sale at about \$4,000,000. He contacted the property agent but was then told that the owner had cancelled the instructions for sale.
- 5.1.5.2 Mrs A was very keen on this apartment and he tried to find out who was the owner. Eventually, he identified the owner through the service of a security guard at the block and made an appointment to see the owner. He saw the owner on a Friday evening. Initially, the owner refused to sell. After a few drinks, however, the owner changed his mind and agreed to sell the apartment on condition that Mr A completed the assignment on the following Monday paying the purchase price of \$3,900,000 in cash.
- 5.1.5.3 He produced two application forms to Bank K each for a cashier order payable to Bank S for the account of an identified company. The application forms were both dated 27 April 1988 and he identified his signature on both. The first, which was admitted as an exhibit and marked 'Exhibit AT-3', was for the sum of \$1,992,910.70 and the second, which was admitted as exhibit and marked 'Exhibit AT-4', was for the amount of \$1,994,389.30. He explained that the sum total of these Cashier Orders was \$3,897,300 namely \$3,900,000 less \$2,700 which he said was the fee payable to the owner's mortgagee's solicitors to discharge the then existing mortgage to Bank S. He did not have a receipt for this fee.
- 5.1.5.4 He delivered the cashier orders and the Taxpayer became the owner. Although the assignment of the property was not delivered until some time later, possession was given and he produced a letter from Hongkong Telephone

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Company Limited dated 24 May 1988 referring to his own as opposed to the Taxpayer's request for the installation of two internal telephone extensions, which was admitted as an exhibit and marked 'Exhibit AT-6', and a receipt and agreement from the Hongkong and China Gas Company Limited for the delivery and installation of a 'Cannon' gas cooker, a document dated 11 May 1988, which was admitted as an exhibit and marked 'Exhibit AT-7'.

5.1.6 The B Shop:

Between being approached to purchase the X Property and paying the initial deposit of \$300,000 and the payment of the purchase monies for the New Residence, in March 1988 Mrs A contracted to purchase the B Shop. The purchase price was paid in full in cash and he produced a receipt issued by the Firm to himself, the receipt being dated 3 March 1988. This was admitted in evidence and marked 'Exhibit AT-5'.

5.1.7 The F Property:

This was not a purchase for himself. He explained that he had loaned some money to a friend and the assignment of this property was a security for that loan. He received the rental income whilst the loan was outstanding and assigned the property when the loan had been repaid.

5.1.8 Summary:

The witness then summarised his evidence:

5.1.8.1 His purchase of the X Property was as an investment for the Taxpayer. His decisions for and on behalf of the Taxpayer were implemented.

5.1.8.2 He had provided the Revenue and the Board with the list of the property transactions to establish that neither he nor his wife were real estate speculators. Investment in property was an alternative to leaving the money in the bank or placing it in the Stock Market.

5.1.8.3 Both he and his wife are cautious investors and having both the New Residence and the X Property would be too great an exposure to property.

5.1.8.4 By the end of April 1988 the position was that he had paid the deposit for the X Property and he had paid the purchase price for both the B Shop and the New Residence. His investment in real estate would be too high if he retained the X Property. Accordingly, he determined to sell the units in the X Property. Agents were instructed to identify buyers and contracts were signed on various dates with completion being when the Occupation Permit was issued. All of the Units but two were sold before the date of the Occupation Permit and those

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two were sold later. The New Residence would be a satisfactory investment in the property market. To retain the X Property would be an unacceptable risk.

5.1.8.5 Prior to the 1987 Stock Market crash his real estate investments, excluding the Old Residence, amounted to \$1,500,000. The purchase price of each the New Residence, the B Shop and the X Property would mean an exposure of \$9,000,000 which he thought was too high. He and his wife had discussed the matter at length and her more cautious approach had prevailed hence the decision to sell the X Property. His next venture into property market was in March 1989 when he purchased the E Property, refer paragraph 3.9 above.

5.1.8.6 He reiterated:

5.1.8.6.1 That he advised the Revenue that neither he nor his wife or any company owned by himself and his wife had ever engaged in trading in property.

5.1.8.6.2 He buys when the market is depressed, as opposed to buoyant, which is the mark of an investor as opposed to a speculator.

5.1.8.6.3 Speculators gear up to maximise profits whereas he and/or his wife pay cash for what they buy rather than borrow.

5.1.8.6.4 The X Property was sold as the New Residence was a better alternative investment. Had the X Property been used as he had been contemplating, namely granting short lets to visitors from the Place Y and Place Z, who would prefer to stay in a residential unit as opposed to an expensive hotel, it would have yielded a very good return.

5.1.9 He complained about the quality of the service the Taxpayer had received from its auditors/tax representatives and said that they might have changed wording he had given. They delayed handling his tax affairs, including delays in the payment of tax and in replying to IRD queries.

5.2 Cross-examination:

5.2.1 The X Property:

5.2.1.1 The receipt dated 23 April 1988 was for the initial down payment. If this \$300,000 had not been paid he would not have been able to purchase the property. The sale and purchase agreement was signed and exchanged later. He accepted that he was not legally committed on 23 April 1988 but, first, if he had not gone ahead he would have forfeited the \$300,000 and, secondly, he had given his word and he was morally committed.

5.2.1.2 He was then questioned in some detail as to the size of the units but denied that he had purchased with a view of selling for profit.

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- 5.2.1.3 He had not sought finance as he had cash available and the market was at the bottom.
- 5.2.1.4 He was unable to be specific as to the date when the decision to sell the property was taken although he had accepted that this must have been fairly close to the date of the purchase of the New Residence. He repeated that having both the New Residence and the X Property left he and his wife overexposed in property and that the decision had been taken after he had paid the purchase price for the New Residence and not before.
- 5.2.1.5 He repeated that he had regarded an exposure of \$1,500,000 in the property market too high in the autumn of 1987 and that by the time he had paid for the New Residence this exposure had increased to \$9,000,000. Levels of exposure mattered and he had sold the Old Residence to reduce the exposure although it could have been retained and rented.
- 5.2.1.6 He was unable to give a date when the estate agents were instructed to dispose of the units in the property although it was after the purchase of the New Residence. He volunteered that he wanted to keep the property, although this would have required securing financing, but that his wife was against retention and her argument had prevailed.
- 5.2.1.7 Although he had talked in terms of short lets for the units he acknowledged that he had not done any feasibility study to assess the viability of such a venture. He confirmed that he had offered the units for sale and volunteered that he offered units to staff of the Firm at a discount. He agreed that most of the units had been sold by the time the Occupation Permit was issued and that the remaining units were sold later. He agreed that it had taken four to five months for the agents to find purchasers for the units sold before the Occupation Permit was issued.
- 5.2.1.8 When pressed as to the date when the decision to sell this property was taken he was unable to give one. He repeated that his recollection was his meeting with the then owner of the New Residence was on a Friday evening or Saturday morning.
- 5.2.1.9 When asked whether he had made any attempts to find out whether his idea of short lets to visitors was or how best to run such an operation his consistent response was in the negative and supplemented by the statement that this was because the decision to sell had already been taken.
- 5.2.1.10 A copy of the sale and purchase agreement for this property was produced by the Revenue and admitted as an exhibit and marked 'Exhibit IRD-1'. He was referred to clause 5, a clause permitting sub-sales and asked why that clause

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was in that agreement. He replied that that was a standard provision which permitted a purchaser flexibility and that every purchaser required flexibility.

5.2.1.11 He was then questioned at length as to when he had done his calculations as to the yield from the investment but it was clear from his answers that not a great deal of thought had been given to this aspect.

5.2.1.12 Having signed the sale and purchase agreement for the property he had neither attempted to find tenants or to obtain short term lets because, by that time, the decision to sell had been taken. For that reason he also confirmed that he had not given any attention to questions as to management of the building, rental collection or maintenance costs although he stated that an employee of the Firm had been keen to do this for him.

5.2.1.13 He confirmed that he had no experience of owning a building as investment.

5.2.2 The New Residence:

5.2.2.1 He was unable to be specific as to dates when he became aware that the New Residence was on the market. He reiterated that his recollection was this was a Friday although it could have been a Monday.

5.2.2.2 It was Mrs A who was looking for a larger residence for them. When he found out that this property was available he was determined to purchase it.

5.2.2.3 When questioned again about how he persuaded the vendor to sell the New Residence he stated that he was having dinner with his sister when he was contacted by the security guard to say he had found out who the owner was.

5.2.2.4 The Taxpayer was used as purchaser on advice from his accountants.

5.2.2.5 The New Residence was provided as directors' quarters and until they moved in they had been living in the Old Residence, a smaller apartment in the same block.

5.2.2.6 The dates for the assignments of the New Residence to the Taxpayer and the Old Residence from himself and his wife did not relate to the dates when contracts were entered into. In his experience an assignment of a property cannot be delivered earlier than twenty-one days after the date of payment of the purchase price as this was the period which would be required for any existing mortgage to be reassigned.

5.2.2.7 He had not sold the Old Residence immediately he had purchased the New Residence as the New Residence needed to be redecorated. They did not move into the New Residence until the first or second week of June 1988 and they had not completed a sale of the New Residence until they moved. He could not

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say whether he had contracted to sell the Old Residence before or after they moved to the New Residence.

5.2.3 General:

5.2.3.1 He declined to identify what he would regard as the optimum level of investment in the real estate market. Further he added that it was Mrs A who regarded the investment in the New Residence, the X Property and the B shop as excessive. He himself was more relaxed.

5.3 Questions from the Board:

5.3.1 The Taxpayer provided the Firm with office accommodation, equipment and staff.

5.3.2 Prior to the purchase of the New Residence the Taxpayer had never provided its directors with residential accommodation.

5.3.3 He had not thought of the X Property as a residence for himself and his wife.

5.3.4 When asked why the Taxpayer was identified as the purchaser for the X Property he stated that he himself was the buyer but as the transaction was being handled by the Firm he ought not to act in a dual capacity. When asked to clarify these dual capacities he identified them as he, personally, being confirmor or assignments to purchasers when the Firm was acting for him. When pressed he stated that he did not think it right for he himself to be purchaser and to act for himself as purchaser. Using Mrs A as purchaser had gone through his mind.

5.3.5 When asked if his evidence was that he had not decided to sell by 16 May 1988 he answered in the negative.

5.3.6 When advised that 27 April 1988 was a Wednesday he said his recollection was that he had met with the then owner of the New Residence on a Friday.

5.3.7 When asked why he had not used another company as purchaser he stated that this was idleness on his part. The Taxpayer was a convenient vehicle.

5.4 Further evidence:

When asked if he was to call any further evidence the witness did not answer but volunteered that over the lunch adjournment he had been doing some calculations and these had reminded him of his yield forecasts when he had been considering purchasing the X Property. He cited figures which, according to his calculations, indicated a 13.4% return which, after property tax, would represent a 11.82% return. No further witnesses were called.

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6. CASE FOR THE REVENUE

6.1 As an introduction to the submission for the Revenue the Board's attention was drawn to:

6.1.1 The issue before it, namely whether the surplus derived by the Taxpayer from the disposal of the X property were profits chargeable to tax under section 14 of the Ordinance;

6.1.2 Section 14 of the Ordinance;

6.1.3 Section 68 (4) of the Ordinance; and

6.1.4 The history of the property transactions as agreed between the parties, as set out in section 3 of this decision.

6.2 The Taxpayer alleged that:

6.2.1 The X Property had been purchased as an investment which would generate rental income and that Mr A had done a mental calculation as to the yield on the investment; and

6.2.2 The intention changed when Mr A was able to purchase the New Residence; and

6.2.3 The decision to sell the X Property was allegedly because it was considered too risky to retain both of these properties.

6.3 Intention:

6.3.1 The Board was referred to the well-known passage in Simmons v IRC 55 TC 461 at page 491, letter G as to intention. The subjective intention is tested by objective facts and circumstances. The Board was also referred to two of its prior decisions, Cases D61/88 and D62/88, IRBRD, volume 4 page 62 and the passage at page 65 thereof namely:

‘ In ascertaining the true intention, it is necessary to consider two tests. Firstly one must look at the subjective intention of the Taxpayer and try to ascertain what was the intention. The second test is then to look at all of the facts objectively and see whether, on the objective construction of the facts, the answer is the same. Obviously, the answer should always be the same and one test should support the other. However, the second “objectivity” test is required because it may be difficult or impossible to establish the intention from a subjective test; clearly self-serving statements by the Taxpayer on their own are of limited value, and I would submit that, if these are the only

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indicators available for “subjective” testing, then the Board must place far greater weight on the objective facts of the case. However, it is clear that the Board must attempt to determine the “true” intention.’

6.3.2 It was submitted that the Taxpayer had failed to establish its intention. There was no contemporaneous record of a directors’ meeting with regard to the purchase of this property and that the only explanation was the oral evidence of Mr A; there were no actual hard facts or hard evidence to collaborate the claimed intention.

6.3.3 The Board’s attention was drawn to the fact that:

6.3.3.1 The building on the X Property was still being constructed and when the sale and purchase agreement was signed and exchanged and it would take some time before it could generate any income.

6.3.3.2 No explanation was given as to why this particular property was suitable as a long-term rental asset.

6.3.3.3 No feasibility study had been undertaken and there was no evidence beyond Mr A’s assertion that he had actually calculated a yield.

6.3.3.4 The evidence was that the Taxpayer never advertised for tenants or taken any steps to secure occupants.

6.3.3.5 There was no evidence to show that there was a market for short lets to visitors from the Place Y and Place Z.

6.3.3.6 Mr A had stated that he had never purchased a building of the same kind before and, accordingly, had no experience in the management of this type of building, let alone the use he had suggested.

6.3.3.7 There was no evidence that the Taxpayer would be able to service the requirements of operating the type of business suggested.

6.3.3.8 A short period between the approach with the offer of the building and the decision to sell it, at most some four months, was not consistent with the claimed intention to hold the property as a long-term investment.

6.3.3.9 There was no evidence that the sale was a forced sale due to some unforeseen circumstances or factors.

The foregoing are strong indicators that the purchase was with a view to on-sale for profit.

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6.4 The Board's attention was drawn to the Taxpayer's audited accounts for the year ended 31 March 1989 and particularly schedule F and the paragraph headed 'reason for sale' which reads:

'All the funds derived from disposal of the properties were utilized to pay against the house properties before mortgage loan has been granted by the related bank.'

It was submitted that this paragraph suggested that the Taxpayer was prepared to sell the X Property rather than obtain long-term finance to carry out its alleged intention.

6.5 Mr A had stated that the sale was decided on only after the New Residence was purchased as he considered it too risky to have too much investment in the property market. In other words that the New Residence was a substitute for the X Property as a long-term investment. It was submitted that the suggestion was unconvincing as:

6.5.1 The evidence was that the Old Residence was sold after the New Residence was acquired whereby the New Residence was a substitute for the Old Residence.

6.5.2 The payment of the initial \$300,000 towards the purchase price of the X Property was only effected two or three days before the entire purchase price for the New Residence was paid and this was before the Taxpayer was contractually committed with respect to the X Property.

6.5.3 If owning both the New Residence and the X Property would result in too great an exposure why did Mr A put the Taxpayer in the position of being contractually obliged to purchase the X Property with additional exposure that would create?

6.5.4 Having received the proceeds of sale of the X Property in September 1988 Mr A then purchased the E Property in January 1989 and the F Property in September 1989.

6.5.5. The X Property was not sold en bloc but unit by unit. The Taxpayer could have reduced its exposure to the local property market and obtained rental income by disposing of some of the units and retaining others.

The foregoing contradicted the evidence as to overexposure.

6.6 The Board was then referred to the passage Turner v Last 42 TC 517 at page 522 reading:

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‘The fact that he did sell Green Field very soon is obviously not conclusive. A man may buy something, whether it be land or a chattel, for his own use and enjoyment with no idea of a quick resale, and then, quite unexpectedly, he may receive an offer to buy which is too tempting to refuse. This is a perfectly possible state of facts: but the fact that there was a quick resale naturally leads one to scrutinize the evidence that it was not envisaged from the first very carefully.’

It was submitted that there was no such evidence to suggest that the Taxpayer was so tempted.

6.7 The Taxpayer had failed to discharge the onus of proof whereby the appeal should be dismissed.

7. REASONS FOR THE DECISION

7.1 The question:

The question for the Board to consider is whether the profit arising on the disposal of the X Property is a profit which is chargeable to tax under section 14 or whether it is not caught by that provision.

7.2 Onus of proof:

The Ordinance is perfectly clear as to the onus of proof on an appeal: section 68(4) of the Ordinance places this firmly on the Taxpayer.

7.3 The evidence:

7.3.1 Personal activities of the Taxpayer’s shareholders:

7.3.1.1 Evidence was adduced as to all of the property transactions which the directors of Taxpayer, Mr A and Mrs A, either individually or jointly, had entered into since 1979. Although it is not for the Board to determine whether Mr A and/or Mrs A were or were not investing when they purchased these properties, so far as the residential premises are concerned all, save for the F Property, were apparently purchased for their personal occupancy whilst the retail outlets would appear to have been purchased for investment. The Board was asked to accept this past conduct as indicative of the fact that the Taxpayer had purchased the X Property as an investment as opposed to trading stock.

7.3.1.2 The Board considers that this evidence is neutral so far as the intentions of the Taxpayer as to the X Property are concerned. It was a different type of property in that it was an entire building comprising several separate units each of some five hundred square feet, none of which alone would appear to be

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suitable for personal occupancy by Mr A and Mrs A (Mr A stated unequivocally that it had never been considered for that purpose) and it is different to one or more single small commercial units.

7.3.2 Prior business of the Taxpayer:

7.3.2.1 It was Mr A's evidence that, prior to the transaction involving the X Property, the Taxpayer's activities were restricted to the provision of office premises, office equipment and staff to the Firm and that neither Mr A nor Mrs A had used the Taxpayer as an investment holding company. Since the payment of the initial deposit, refer paragraph 5.1.4.6 above, the Taxpayer has acquired the New Residence, which is provided to Mr A and Mrs A as, according to schedule (b) to the audited accounts, fully furnished 'directors' quarters'. Accordingly, the provision of 'directors' quarters', and whether or not furnished, was an extension of its activities as a service company to the Firm.

7.3.2.2 Throughout the appeal Mr A took the position that Mrs A, the Taxpayer and himself were, effectively, indistinguishable and that the Board should treat his decisions as to the X Property as the decisions of the Taxpayer. Unfortunately, the Board is unable to accept this. An incorporated entity is a distinct legal entity and whilst, as an inanimate entity, its decisions of necessity have to be the decisions of its directors, those decisions have to be treated as the decisions of the entity and require to be formally recorded in minutes.

7.3.2.3 The Board has some difficulties in understanding why the routine and straightforward operations of the Taxpayer as a service company to the Firm were potentially to be compounded by the acquisition of a building to be held for rental income with the new administrative obligations that would entail. Mr A's explanation, when asked why a different vehicle was not used, casually put it down to idleness on his part. The Board is compelled to question whether that was why a Board minute with respect to the property could not be produced either in response to the request from the IRD or as a material exhibit at the hearing of the appeal.

7.3.3 Documentary evidence:

The documentary evidence with respect to the X Property comprises the audited accounts of the Taxpayer and five documents, refer 7.3.3.2 below.

7.3.3.1 The audited accounts

The only relevant information to be extracted from these accounts is:

7.3.3.1.1 The two 'Remarks' in schedule (f):

'(i) Intention of acquisition

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It was originally acquired by the company for long-term investment, in the hope of producing rental income for the current year.

(ii) Reason for sale

All the funds derived from disposal of the properties which are utilized to pay against the house properties before mortgage loan has been granted by the related bank.'

The first of these 'Remarks' contains a contradiction; a long-term investment is to be expected to produce rental income for so long as it is held, as opposed to 'the current year'. The second is simply not supported by Mr A's evidence, and see paragraph 7.3.3.1.3 below. Mr A signed these audited accounts.

7.3.3.1.2 Unless Mr A's explanation noted in paragraph 7.3.3.1.3 below is incorrect, the audited accounts do not reflect the fact that Mr A, as opposed to the Taxpayer, financed the payments evidenced by Exhibits AT-1, AT-3 and AT-4. There is no apparent interest charge with respect to the advance of the \$300,000 or the purchase price of the New Residence and the latter is not reflected as a loan from shareholders. They do show that a loss had been carried forward from its year ended 31 March 1988.

7.3.3.1.3 The balance sheet discloses a mortgage loan of \$3,396,760.70 (1988 nil) and the profit and loss account includes 'Mortgage Loan Interest' as paid. When questioned as to this mortgage loan Mr A stated that the mortgage had not been raised to finance the purchase of either the X Property or the New Residence but to raise money for some project of Mrs A. Mr A's evidence dictates that the accounts ought to have reflected the loan of \$3,900,000 from the shareholders and the loan to Mrs A. 'Turnover' is described in note 1 (b) to the accounts as 'management fee received in respect of consultancy services' whereby there is no apparent interest receipt from shareholder(s).

7.3.3.1.4 Overall, the Board does not consider that any evidence to corroborate Mr A's evidence is provided by the audited accounts.

7.3.3.2 Other documents:

7.3.3.2.1 These were Exhibits AT-1 and AT-2, refer paragraph 5.1.4.6 above, Exhibits AT-3 and AT-4, refer paragraph 5.1.5.3 above, and Exhibit IRD-1, refer paragraph 5.2.1.9 above.

7.3.3.2.2 The Board does not consider that any assistance is afforded by these documents save that they confirm Mr A's evidence that he provided the funds used and that the full deposit for the X Property amounting to \$1,440,000 was paid.

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7.3.4 Mr A's evidence.

7.3.4.1 The circumstances as to how Mr A became the purchaser of the X property are set out in paragraphs 5.1.4.1 to 5.1.4.6, both inclusive, above and what he had in mind for the property is set out in paragraph 5.1.4.7. His reason for his claimed change of intention is set out in paragraph 5.1.8.4 above. Accepting that Mr A and Mrs A always discussed their investment policy and that Mrs A was cautious, the Board is of the view that it is more likely that, having paid the 'earnest money' for the X Property and the purchase price for the New Residence within the same week, they would have discussed what to do about the former sooner rather than later. They were not legally obliged to proceed but if they did not the 'earnest money' would be forfeited.

7.3.4.2 For reasons associated with the operation of a business of the nature described by Mr A, which the Board does not consider it necessary to rehearse in this decision, the Board is unable to attach any credibility to his evidence that the provision of accommodation for visitors from the Place Y and the Place Z had been determined as the intended use for the X Property for the reason, according to his contemporaneous calculations, that that use would have maximised the return on the investment. His evidence was that during the period between the offer and until the decision to sell was taken, a period of almost four months, he had done nothing to find out whether this projected use was practical. His explanation was that this was because the decision to sell had been taken.

7.3.4.3 Mr A was distinctly vague on the dates when steps were taken by him:

7.3.4.3.1 He advised the IRD, when interviewed on 30 August 1991, that his decisive meeting with the then owner of the New Residence took place on a Friday and that his agreement with this individual required him to pay the agreed price on the following Monday. He repeated this in his evidence. Between the interview in August 1991 and the hearing of the appeal he had obtained copies of his applications for cashier orders, Exhibits AT-1, AT-3 and AT-4, and located two receipts, Exhibits AT-2 and AT-5. However, he does not appear to have taken the trouble to identify the weekdays on which these documents were created. That exercise may have assisted his memory. The 23 April 1988 was a Saturday and 27 April 1988 was a Wednesday. He was unable to offer any explanation when he was told that 27 April 1988 was a Wednesday.

7.3.4.3.2 He did not identify when either he or Mrs A decided they would like a larger residence or when they or either of them approached an agent to identify a suitable property or whether they had decided that it had to be in the same block as the Old Residence. He did not identify when the agent notified Mrs A that the then owner of the New Residence was willing to sell. He did not specify the interval between the advice from the agent that the owner had decided not to sell and the owner being identified by the security guard.

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Bearing in mind the short interval between the applications for the cashier orders for the 'earnest payment' for the X Property and the entire purchase price for the New Residence, this could have been evidence of some materiality.

- 7.3.4.3.3 He was either unable or had not taken the trouble to seek assistance from the agent appointed to find purchasers for the units in the X Property as to when the instructions were given. It is reasonable to assume that the agent would have had some records which may have assisted in fixing this date.
- 7.3.4.3.4 Also in his interview by the IRD Mr A quoted an annual return on the investment of between 9% and 12% and before the Board gave a figure similar to the high percentage. As explained by him, the figure quoted was no more than the total of an estimated monthly income per unit multiplied by twelve. His calculation lacks credibility as, as explained, it did not take into account any maintenance or administration costs or, for that matter, the possibility that there would be periods when there were no visitors using the facility he had in mind.
- 7.3.4.4 Mr A was reluctant to be specific when questioned by the representative of the Revenue as to what he would consider to be a prudent exposure to the local property market. However, his evidence was that \$1,500,000, in or about October 1987, and \$9,000,000, by the end of April 1988, was too much. Conversely, whilst considering the offer of the X Property at \$4,800,000, an offer which was made in January 1988, Mrs A paid \$823,000 for the B Shop in March 1988 and in April 1988 they paid the purchase price for the New Residence and continued to own the Old Residence. In January 1989 Mr A paid \$2,700,000 for the E Shop. Whilst the last of these purchases was made after the disposal of all units in the X Property and the Old Residence, it does mean that within about seven months of the decision to cut down their exposure Mr A and Mrs A had taken on an actual exposure considerably in excess of that considered excessive such a short time previously. His explanation that prices were low and that bank interest was low indicates opportunism as opposed to caution. The Board considers that there is a considerable degree of inconsistency between Mr A's explanations and the facts.
- 7.3.4.5 The most charitable conclusion to be drawn from Mr A's evidence is that his recollection for the dates on which material events occurred is nonexistent and he had not appreciated how relevant such information was to this appeal. One particular conclusion is that his actions were not always the result of careful preplanning. Particularly, he had taken no steps to incorporate or purchase a company to acquire the X Property and the Taxpayer became the purchaser for no better reason than laziness on his part. The Board has to suspect that this explanation conceals the real reason, namely that the choice of a purchaser had ceased to be a matter for concern as the decision to sell had been taken by the

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time the sale and purchase agreement was required to be signed and exchanged.

7.3.5 Mr A's evidence as to discussions with Mrs A, discussions with an employee of the Firm and his instructions to the agent establish that he ought to have been able to call witnesses to corroborate his evidence and fix times when events occurred. The total absence of corroboration compels the Board, with considerable reluctance, to the conclusion that it must treat Mr A's evidence as self-serving and, accordingly, the Board attaches no weight to those parts of his evidence which are not corroborated by one or more of the documents which were before it.

7.4 Change of intention:

The Board accepts that an investor is at liberty to change his/its mind as to the retention of an asset acquired as a long-term investment. The classic circumstances are the offer which cannot be refused, the identification of a more suitable investment or, so far as personal residences are concerned, the identification of one more suitable to, and as examples, the owner's improved or reduced circumstances or increased or lesser requirements.

7.5 Finding as to intention:

Mr A's evidence as to his and/or Mrs A's activities in the local property market and the reasons for those activities have been summarised in section 5 of this Decision and need not be rehearsed again. The Board does not consider that his evidence assists in the establishment of the Taxpayer's intention. In the absence of evidence to corroborate Mr A's evidence the Board is obliged to find that the Taxpayer has failed to establish its intention.

7.6 Substitution of investment:

It was suggested that the New Residence was acquired as it was regarded as a more suitable investment than the X Property. The Board considers this suggestion to be misconceived. Unlike the intention claimed for the X Property the New Residence was not acquired for the production of rental income; it was acquired to meet what must be presumed to be a contractual obligation to provide fully furnished 'directors' quarters'. The Old Residence is not relevant to this suggestion as the Taxpayer was not and had never been the owner of the Old Residence and Mr A did say that the Taxpayer had not provided the Old Residence as 'directors' quarters'. That evidence is corroborated by schedule (b) to the audited accounts which itemises the 'additions to furniture and fixtures' during the Taxpayer's year ended 31 March 1989, a list which includes such basic items as a bed and mattress.

8. DECISION

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The Ordinance places the onus of proof on the Taxpayer. For the reasons stated in section 7 above, that onus has not been discharged by the Taxpayer to the satisfaction of the Board. Accordingly, this appeal is dismissed.