

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D50/95

**Profits tax** – sale of property – intention at acquisition to be for family residence – whether intention to retain genuinely held, realistic and realisable.

Panel: Robert Wei Wen Nam QC (chairman), Ho Chi Ming and Kenneth Ting Woo Shou.

Date of hearing: 9 June 1995.

Date of decision: 21 August 1995.

The taxpayer purchased a property which was then under construction, and subsequently sold it at a profit after the issue of the occupation permit. At the time of acquisition, there was no decision and therefore no intention to move in when the construction was completed. The taxpayer had not resided at the property but argued that he intended to use it as the family's residence.

Held:

Any wish or contingent hope to be somehow able to retain the property as residence would not have been sufficient to support a finding of an intention to retain the property, an intention which was 'genuinely held realistic and realisable'.

**Appeal dismissed.**

Cases referred to:

Simmons v IRC STC 350

All Best Wishes Ltd v CIR 3 HKTC 750

Yim Kwok Cheong for the Commissioner of Inland Revenue.

Taxpayer in person.

**Decision:**

1. This is an appeal by an individual (the Taxpayer) against the profits tax assessment raised on him for the year of assessment 1992/93 as revised by the determination of the Commissioner of Inland Revenue dated 18 January 1995. It was his contention that the profit made on the resale of a flat (the Subject Property) was a capital gain and was not

## INLAND REVENUE BOARD OF REVIEW DECISIONS

assessable to profits tax because, at the time of acquisition, he had intended to retain the Subject Property as a long-term investment, that is, as his residence.

2. The Taxpayer appeared in person. He gave testimony for himself. No other witness was called.

3. We have found the following facts which were not disputed.

3.1 In July 1988, the Taxpayer's wife purchased a flat in District A (the District A Property) for \$770,000. The purchase was financed by a mortgage loan repayable by a number of monthly instalments of \$8,200 each. At all relevant times, the monthly instalments were payable.

3.2 The Taxpayer and his wife have resided at the District A Property ever since, except for the period from February 1994 to July 1994.

3.3 On 26 March 1991, the Taxpayer purchased the Subject Property in District B for \$743,070. The Subject Property was under construction.

3.4 The purchase was financed by (1) a loan of \$618,763 secured by the mortgage of the Subject Property and repayable by 180 monthly instalments of \$7,186 each commencing 9 May 1991 and (2) a loan of \$200,000 secured by a second mortgage of the District A Property and repayable by 120 monthly instalments of \$2,928 each commencing 27 April 1991.

3.5 The Taxpayer and his wife have 2 sons, born on 17 October 1977 and 24 October 1985 respectively. In 1991 the elder son was in Form 1, while the younger one was in kindergarten. The Taxpayer was earning \$8,435 per month as a sales executive of a trading company; his wife was earning about \$10,000 per month as a secretary in an import-export firm.

3.6 In about February 1992, construction of the Subject Property was completed.

3.7 On 24 April 1992, the Taxpayer sold the Subject Property for \$1,400,000. The sale was made after the issue of the occupation permit. Before the sale, the Taxpayer had not resided at the Subject Property.

3.8 On 23 July 1992, the Taxpayer purchased a flat in District C (the District C Property) for \$2,010,000. The purchase was as to \$1,400,000 financed by a loan repayable by 180 monthly instalments commencing February 1994. The Taxpayer resided there during the period from February 1994 to July 1994. It was let for the period from April 1994 to August 1994.

4. The question of whether a profit derived by a person from the sale of his property is subject to profits tax turns on his intention at the time of the acquisition of the property: if he intended to dispose of it for a profit, the property was a trading asset and the

## INLAND REVENUE BOARD OF REVIEW DECISIONS

profit is a trading profit and is subject to profits tax; on the other hand, if the intention was to hold it as a long-term investment, it was a capital asset and the profit is a capital gain and is not subject to profits tax. At any given time, an asset is either a long-term investment or trading asset; it cannot be both; it cannot be neither. (See Simmons v IRC STC 350 at 352.) As to the meaning of ‘intention’, Mortimer J said in All Best Wishes Ltd v CIR 3 HKTC 750 at 771:

*‘The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can provide the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person’s intention are commonplace in the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said that actions speak louder than words...’*

5. In his letter dated 21 February 1995 and addressed to the Clerk to the Board of Review which was treated as his statement of grounds of appeal at the hearing, the Taxpayer stressed (1) that he was a property investor, (2) that as he had never owned any property before, he had his wife’s strong support in making his wish come true and (3) that the fact that he had paid more than 13 monthly instalments before he sold the subject property meant that it was a ‘property investment’. He cited some of the letters exchanged between him and the Revenue in support of his contentions. These letters are referred to in paragraphs 7 to 9 below.

6. The Taxpayer’s letter to the Revenue dated 8 April 1994, which was not cited in the statement of grounds of appeal, reads, so far as it is relevant, as follows:

‘... I had borrowed money from the bank, friends and relatives and the visa account and needed to repay them. Therefore, I disposed [sic] the unit when there was a good price.

The existing residence belongs to my wife and she is responsible for the monthly mortgage loan repayment of \$8,200 while I am responsible for all other expenses. We borrowed money to buy the [Subject Property] in order to make a bet so that we might not need to be poor for the rest of our lives ...

... I had only intended for gaining some maintenance fees so that I could live an “improved” “human-like” life ...’

## INLAND REVENUE BOARD OF REVIEW DECISIONS

7. The Taxpayer's letter to the Revenue dated 13 April 1994, so far as it is relevant, reads as follows:

'I purchased [the District C Property] in July 1992.

Consideration	:	\$2,010,000.00
Monthly instalment	:	\$13,649.87
Date of occupation	:	18-2-1994
Purpose	:	self-residence'

8. By a letter dated 8 July 1994, the Commissioner of Inland Revenue offered to settle the Taxpayer's objection to the 1992/93 assessment for \$370,213. The Taxpayer did not accept the offer.

9. The Taxpayer's letter dated 21 July 1994 to the Revenue, so far as it is relevant, reads as follows:

- '(1) I hereby declare that I have never invested in properties or participated in property speculation ever since I turned 18 and prior to my 50 years of age. I would like you to show your record if you suggest otherwise.
- (2) I have to support my wife and two children as well as my mother. With a meagre salary due to a low level of education, we had long been unable to make ends meet despite living frugally (as proved by my demand note). In order to maintain the basic living, we were compelled to borrow money from our friends and relatives or through visas. The debts amounted to \$260,000 in total, including the mortgage loan (supporting documents will be submitted if required).
- (3) In order to strengthen our financial situation by means of lowering the living standard and cutting the living expenditures, we purchased [the Subject Property] with a mortgage loan from the ... Bank. Repayment was made right away (copies of supporting documents attached).
- (4) We were ready to move in after we had paid about 13 instalments in addition to the legal costs, management fees, etc and completed the procedures for occupation (copies of supporting documents attached).
- (5) Later, after taking into account the need to pay all debts, including those incurred via visas, the inconvenience my two children faced in going to and from school, and domestic problems, etc, we decided to dispose [the Subject Property] (copies of supporting documents attached).

## INLAND REVENUE BOARD OF REVIEW DECISIONS

...

10. On the purchase and resale of the Subject Property, the Taxpayer's testimony is briefly this. In 1982 his wife had purchased a property in District D. In 1988 she purchased the District A Property. So she encouraged the Taxpayer to become a property owner too so as to fulfil his wish. His idea was to purchase the Subject Property, use it as the family's residence and sell the District A Property. He reckoned that the proceeds of sale would cover all the instalments for the Subject Property and still leave a surplus to live on. He thought that, after moving to the Subject Property, he could cut down on living expense. However, there was no solution to the children's school problems. As he and his wife were both working, his father-in-law was looking after the children, but they could not ask him to come and live in District B. The Taxpayer considered the possibility of finding schools in District B, but knew that it would not work. In the circumstances they had to sell the Subject Property.

11. For the reasons shown below, we are unable to accept the Taxpayer's testimony as to his reasons for the purchase and the resale as summarised above.

11.1 The Taxpayer produced no projections or estimates to show how by purchasing and moving into the Subject Property and selling the District A Property, his financial position would have been improved.

11.2 The school problems and the father-in-law problem must have been foreseeable at the time when the Taxpayer was deciding whether to purchase the Subject Property. There was no explanation as to why, despite the foreseeability of those problems, he went ahead with the purchase.

11.3 On the other hand, the Taxpayer's letter dated 8 April 1994 (see paragraph 6 above) stuck a different note when it stated that 'I had borrowed money from the bank, friends and relatives and the visa account and needed to repay them. Therefore, I disposed the unit when there was a good price', that 'We borrowed money to buy the [Subject Property] in order to make a bet so that we might not need to be poor for the rest of our lives', and that 'I had only intended for gaining some maintenance fees so that I could live an "improved" "human-like" life'. The letter suggested that in making the purchase, the Taxpayer's intention was to make a profit by resale if and when there was a good price for it. The purchase was made with borrowed money which had to be repaid, and a good price might or might not be obtainable. That, we think, was the bet.

11.4 The Taxpayer's letter dated 13 April 1994 (see paragraph 7 above) sets out the particulars of the purchase of the District C Property, including the date of purchase which was some 3 months after the sale of the Subject Property. No specific argument was put forward, but the implication seems to be that in acquiring the District C Property, the Taxpayer was making a long-term investment. Assuming (without deciding) that the implication was true, that, together with the particulars of the purchase, including the date of purchase, would not in our view have amounted to evidence relevant to the issue of whether,

## INLAND REVENUE BOARD OF REVIEW DECISIONS

in acquiring the Subject Property, the Taxpayer was making a long-term investment. In any event, any relevance would have been so marginal that it would not have carried the matter any further.

11.5 When replying to the submissions of Mr Yim, the representative of the Commissioner of Inland Revenue, the Taxpayer stated that as he and his wife were both busy, they did not make any decision about moving in, that they were to make a decision about schools when the construction was completed and that upon completion, they would make a decision about whether to move in or not. Those statements show that at the time of the acquisition, there was no decision and therefore no intention to move in when the construction was completed. Any wish or contingent hope that they would somehow be able to retain the Subject Property as their residence would not have been sufficient to support a finding of an intention to retain the Subject Property, an intention which was 'genuinely held, realistic and realisable'. (See paragraph 4 above.)

12. Taking into consideration all the facts found, the Taxpayer's testimony, the letters referred to above, and the Taxpayer's statements in reply to Mr Yim's submissions, we find the statements quoted from the letter dated 8 April 1994 (see paragraph 11.3 above) speak the truth. We further find that in acquiring the Subject Property, the Taxpayer intended to embark on an adventure in the nature of trade by resale at a profit, that the Subject Property was a trading asset and that the profit derived from the resale is a trading profit and is subject to profits tax.

13. It follows that this appeal is dismissed and that the assessment in question as revised is hereby confirmed.