

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D53/03

Profits tax – disposition of units in small house – whether the units were capital or trading assets.

Panel: Ronny Wong Fook Hum SC (chairman), Herman Fung Man Hei and Francis Lui Yiu Tung.

Dates of hearing: 16 June and 29 July 2003.

Date of decision: 24 September 2003.

The appellant was the son of Mr A. In 1992, by a deed of gift from Mr A and through exchange of lands, the appellant became the absolute owner of a lot of land.

The appellant built a small house on the lot. In 1998, he disposed of the units of the small house and made gains.

The appellant claimed that he had an agreement with Mr A to divide the small house between Mr A, Mr C (another son of Mr A who passed away in 1997) and himself. All of them intended to hold their units as a residence on a long term basis.

Held:

1. The Board accepted that there might be the agreement to divide the small house. However, the Board did not accept that all of them intended to hold their units as a residence.
2. The Board found Mr A had been residing in Australia before 1961 and it was improbable that he intended to reside in the small house.
3. Mr C was born in Australia. There was no evidence that he ever visited the village prior to his death in 1997. It is fanciful to suggest he intended to reside in the small house.
4. For the appellant, his tie with Hong Kong is also tenacious. He stayed in Hong Kong for processing the small house application and looking after Mr A's properties. The Board did not think he intended to use the small house as his residence.

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Appeal dismissed.

Cases referred to:

Simmons v IRC (1980) 53 TC 461
All Best Wishes Ltd v CIR (1992) 3 HKTC 750

Chow Chee Leung for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Background

1. Mr A was born in Hong Kong in about 1929. His parents were farmers in Hong Kong. The Appellant is his son from his first marriage.
2. Mr A re-married Ms B in Australia on 26 September 1971. Ms B gave birth to a son Mr C in Australia in about 1975. Mr C passed away in Australia on 2 April 1997. According to his death certificate, he was then working as a kitchen hand.
3. Mr A passed away in Australia on 22 March 2000. According to his death certificate, he was a restaurant proprietor at the date of his death.
4. Mr D is the brother of Mr A. According to two 'Succession' memorials dated 1 November 1961, they became 'Successors' to various lots in District E hitherto registered in the name of Mr F. These include lots numbers 1, 2 and 3 in District E demarcation district XXX. The two memorials were signed by one Mr G for and on behalf of Mr A and Mr D who were 'both now abroad'.
5. By a deed of gift dated 16 April 1992, Mr A and Mr D transferred lot number 1 in demarcation district XXX ('Lot 1') by way of gift in favour of the Appellant and Mr H as tenants in common in equal shares. According to this deed, all of them were residing at Address I in Australia.
6. By another deed of gift dated 25 August 1992, the Appellant and Mr H transferred by way of gift Lot 1 in favour of Mr J and Mr K. Lot 1 was thenceforth held between the four of them as tenants in common in equal shares. A village house in District E ('the Village House') was given as the address of all of them.

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7. By a deed poll dated 8 October 1992, Lot 1 was subdivided into four sub-lots. Pursuant to a deed of exchange dated 11 January 1993, the Appellant became absolute owner of section A of Lot 1. By a grant dated 4 October 1995 ('the Grant'), the Appellant surrendered in favour of the Government section A of Lot 1 and obtained in return lot number 4 in demarcation district XXX ('the Relevant Lot').

8. By application dated 12 May 1992, the Appellant applied to the District Lands Office, District E ('District E DLO') to build a 'small house' on Lot 1. This was approved by District E DLO on 2 November 1994. By letters dated 4 October 1995 and 14 October 1996, District E DLO granted in favour of the Appellant various exemptions in respect of site formation, drainage and building works to be carried out on the Relevant Lot.

9. By a certificate dated 9 January 1998, District E DLO certified completion of building works on the Relevant Lot. Four days after the issuance of that certificate, the Appellant applied to District E DLO for removal of the non-alienation clause in the Grant. That restriction was duly removed upon payment by the Appellant on 3 August 1998 of premium in the sum of \$1,985,500.

10. By agreements dated 7 and 31 August 1998, the Appellant disposed of the First and the Ground Floors of the small house erected on the Relevant Lot. By a further agreement dated 2 August 1999, the Appellant disposed of the Second Floor and the Roof of the small house. The issue before us is whether the Appellant is liable for profits tax in respect of the gains he made arising from his dealings of the Relevant Lot.

Case of the Appellant

11. According to the answers given by the Appellant in response to a questionnaire of the Revenue, the Ground, First and Second Floors of the small house were all intended to be 'residence'. He gave the following reasons for selling the units:

'The reasons for sale of three properties are that I have made the decision to look after my sickness father who are accommodated in Australia. In order to stay with my father in Australia and provide better medical service to my father, I decided to sell the properties so that I had enough money to live in Australia for a period of time'.

12. In correspondence with the Revenue and in the course of his sworn testimony before us, the Appellant maintained that:

- (a) His father Mr A returned to Hong Kong in 1992 and was told about the right of an indigenous villager to apply for construction of a small house in the village. Given the village lots then held by Mr A, it was decided that an application

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should be made. In view of the then age of Mr A, the Appellant was nominated to make the application.

- (b) Prior to the deed of gift dated 16 April 1992, he agreed with his father that the small house eventually erected would be divided between his father taking the Ground Floor, his half brother Mr C taking the First Floor and he himself taking the Second Floor and the Roof.
- (c) He intended to return to Australia after submitting the application but decided to stay in Hong Kong to look after the other properties of Mr A.
- (d) Mr A became indisposed in Australia in 1996. Substantial sums had to be spent on his medical expenses. Mr C passed away in April 1997. Ms B was pressing him for Mr C's entitlements. It was in these circumstances that he sold the Ground and the First Floors of the small house.
- (e) He intended to retain the Second Floor and the Roof as his residence. He did not move in as he was travelling between Hong Kong and Australia and he could stay in the Village House.
- (f) He sold the Second Floor and the Roof in 1999 because his wife was then operating a restaurant in Australia through Company C. The business was being carried on at a loss. The Second Floor and the Roof had to be sold in order to finance that business.

The applicable principles

13. The intention of the Appellant at the time of acquisition of the Relevant Lot is crucial in determining whether the units in the small house were capital assets or trading assets. As stated by Lord Wilberforce in Simmons v IRC (1980) 53 TC 461

'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?'

14. An intention to hold property as a capital investment must be definite. The stated intention of the taxpayer is not decisive. Actual intention can only be determined objectively. In All Best Wishes Ltd v CIR (1992) 3 HKTC 750 Mortimer J gave the following guidance:

'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

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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'.

15. Under section 68(4) of the Inland Revenue Ordinance, the onus of proving the assessment appealed against is excessive or incorrect is on the Appellant.

Our decision

16. It is the Appellant's case that he had an agreement with Mr A to divide the small house between Mr A, Mr C and the Appellant himself. Given the relationship between the parties and the fact that the Relevant Lot originated from Mr A, we accept that it is likely that the Appellant and Mr A did agree to split the entitlements. What we find difficult is the Appellant's further contention that Mr A, Mr C and the Appellant himself intended to hold each of their unit as a residence on a long term basis.

17. Mr A was a restaurant proprietor in Australia. According to the succession memorials dated 1 November 1961, he was already residing abroad at that juncture. By agreements dated 5 October 1993, Mr A and Mr D sold various units in lot number 3 in demarcation district XXX. By further agreements dated 29 November 1994, they disposed of units in lot number 2 in demarcation district XXX. Given his long period of absence from Hong Kong, we find it improbable for Mr A to harbour any wish to reside in the small house erected pursuant to the Appellant's application.

18. Mr C was born in Australia. There is no evidence that he ever visited the village in District E prior to his death in 1997. The suggestion that he intended to reside on the First Floor of the small house is fanciful.

19. The Appellant's tie with Hong Kong is also tenacious. He stayed in Hong Kong for the purpose of processing the small house application and looking after the properties of Mr A. Although he represented to District E DLO in his application for small house that he was working as a salesmen, he confirmed in response to questions from this Board that he did not hold any employment in Hong Kong. At all material times, his wife was operating a restaurant in Australia. We are not convinced in these circumstances that he intended to utilise the Second Floor of the small house as his family home.

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20. For these reasons, we hold that the Appellant failed to discharge his onus of proof and we confirm the assessment.