

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D60/00

**Profits tax** – sale of property – whether capital gain or trading gain – whether the sale and purchase of the property amounted to an adventure in the nature of trade.

Panel: Robert Wei Wen Nam SC (chairman), Colin Cohen and Mary Teresa Wong Tak Lan.

Dates of hearing: 28 April, 4 and 13 May 2000.

Date of decision: 27 September 2000.

The taxpayers purchased the property for \$4,229,400 in 1995. The purchase was financed by a bank loan of \$2,960,580 which was repayable by 60 monthly instalments of \$63,268.00. On 11 November 1996, the taxpayers sold the property for \$5,700,000.

The assessor was of the opinion that the purchase and sale of the property amounted to an adventure in the nature of trade.

#### **Held:**

1. In considering whether an asset is a trading asset or a capital asset, one has to consider the intention which existed at the time of acquisition of the asset. (Lionel Simmons Properties Ltd v CIR 53 TC 461 and All Best Wishes Ltd v CIR 3 HKTC 750 considered and applied).
2. The onus is on the taxpayer to prove, on a balance of probabilities, that at the time of acquisition of the subject property, their intention (collectively and individually) was to hold it as a capital asset for residential use and that such intention was genuinely held, realistic and realisable.
3. Where a property is owned by more than one person, the intention and the ability to carry it into effect must be proved in respect of each co-owner individually and in respect of all the co-owners collectively (D121/95, IRBRD, vol 11, 183 at page 189 applied).
4. The Board found that, when acquiring the property, the taxpayers had a common long-term investment intention towards the property on the basis that the taxpayers and their family members should all live together and that the second taxpayer

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should look after the first taxpayer and her children and take care of the second taxpayer's father's business. It follows that they acquired the property as a capital asset. The sale of the property marked the frustration of the plan for a long-term holding which had given rise to the common long-term-investment intention. It has been bought as a capital asset and it was sold as a capital asset. The profit arising from the sale is capital profit and not assessable to profits tax.

### **Appeal allowed.**

Cases referred to:

Lionel Simmons Properties Ltd v CIR 53 TC 461  
All Best Wishes Ltd v CIR 3 HKTC 750  
D121/95, IRBRD, vol 11, 183

Chan Tak Hong for the Commissioner of Inland Revenue.  
Taxpayers in person.

### **Decision:**

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

1. In this appeal Ms A and Ms B (the first Taxpayer and the second Taxpayer respectively and the Taxpayers collectively) appeal against the profits tax assessment for the year of assessment 1996/97 raised on them as revised by the Commissioner of Inland Revenue. They contend that the profit derived from the sale of a flat in Housing Estate C in the New Territories (the subject property) is not assessable to profits tax.

#### **Facts giving rise to the assessment**

2. By a memorandum for sale dated 28 October 1995, the Taxpayers purchased the subject property as joint tenants together with two carparking spaces at a total consideration of \$4,229,400. At the time of the purchase, the property was still under construction.

3. The occupation permit of the subject property was issued on 3 April 1996. It was assigned to the Taxpayers on 17 May 1996. To finance the purchase, the Taxpayers obtained a bank loan of \$2,960,580. The mortgage loan and interest thereon were repayable by 60 monthly instalments of \$63,268 each.

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4. By a provisional agreement dated 11 November 1996, the first Taxpayer acting on her own behalf and her husband Mr D acting for and on behalf of the second Taxpayer sold the subject property at a consideration of \$5,700,000. The sale was completed on 30 December 1996.

5. By a provisional agreement dated 25 November 1996, the first Taxpayer and her husband Mr D purchased another flat in Housing Estate C together with one carparking space at a total consideration of \$6,100,000.

6. The assessor was of the opinion that the purchase and sale of the subject property amounted to an adventure in the nature of trade and raised on the Taxpayers the profits tax assessment for the year of assessment 1996/97 which was revised by the determination of the Commissioner to assessable profits of \$1,331,244 with tax payable thereon of \$199,686.

### **Hearing, parties and witnesses**

7. At the first hearing of this appeal, the first Taxpayer's husband Mr D appeared as her representative. The first Taxpayer was in attendance, but the second Taxpayer was absent, nor was she represented. Miss Chan Tak-hong, assessor, appeared as the Commissioner's representative.

8. The subject property was owned by the Taxpayers as joint tenants, and their intention in acquiring the property was in issue. It was in the Board's view desirable that both the Taxpayers, if possible, should be before the Board. The hearing was adjourned for a while to let the parties consider the matter.

9. When the hearing resumed, the second Taxpayer was before the Board. At her request, she was allowed to take part in the proceedings. Leave was given to her to join as a second appellant and to file appeal papers out of time to remove any doubt as to whether she was part of this appeal. At her request, she was permitted to adopt those portions of a written statement filed by the first Taxpayer for use in the appeal which related to the second Taxpayer. In her own words, 'the part that relates to me, that is true, that is fact.' Towards the end of the hearing, she filed a statement of grounds of appeal which is briefly as follows:

' She was not assessable to profits tax on the profit arising from the sale of the subject property on the following grounds:

- 1) She obtained no share of the profit at all.
- 2) The subject property was acquired for residential accommodation of her family and herself, in case she required to look after the family.'

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10. The second Taxpayer gave evidence first, followed by Mr D, No other witness was called.

### **The second Taxpayer' s testimony**

11. The second Taxpayer' s testimony may be summarised as follows:

#### In chief

- 11.1 She is a daughter of Mr D. She had been studying in a university in Canada until August 1955 when she came back to Hong Kong. Shortly after that she started work in her father' s company, Company E.
- 11.2 While she was working in that company, her father bought the subject property in the names of herself and her stepmother, the first Taxpayer. He paid for the house. He wanted the second Taxpayer to take care of the family, which meant the two stepbrothers and one stepsister, the children of the first Taxpayer and Mr D. He was planning on the basis that they could live together in the new house.
- 11.3 She accepted what her father suggested to her, and she agreed that it was her obligation to take care of her brothers and sisters. Her father brought them to the real property company. During that time they did talk to each other a lot. That was before the actual purchase.
- 11.4 In August or September 1996 she resigned from her father' s company because she and her father had different points of view about the property. After her resignation, her father did not want her to own the property any more. He asked her to sign a document to give him authority to sell the apartment, which she did. After that, she did not contact her father any more.
- 11.5 After they signed the purchase agreement in the real estate agency, her father and she herself went up to the new apartment several times to plan the decoration of the house. But they did not do anything because of the conflict that soon came between them. They could not compromise. Then she resigned.
- 11.6 Her father had a car spare parts business in Japan. During the period when she worked in her father' s company, she frequently travelled between Japan and Hong Kong, so she suggested to her father to buy another

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apartment in her name only. This happened after they had talked about renovation.

- 11.7 He asked her why. She told him that she wanted a place of her own. She requested him to pay the deposit and she would be responsible for the instalments for the apartment. He totally disagreed, saying that he had already bought her the subject property, so why should he give her extra money for another place under her name.
- 11.8 Her father always worried about his health and her stepmother's health and he was afraid that if either one passed away there would be nobody to take care of the younger brothers and sister. They were still young. He wanted her to take care of them in case of that. They would come and live with her in the flat if anything happened to her stepmother and her father.
- 11.9 She remembers asking her father why put the subject property in both names, and her father told her that it was for the balance, so neither of them could sell it for her own interest.
- 11.10 The idea was to tie them together. She had no comment on the idea initially, but after she talked with her own mother and her friends about the matter, they told her to offer an alternative to her father. That was to buy another house under her name.
- 11.11 She remembers she was in Japan when she put this alternative to her father over a long-distance call. That was two to three months after the completion by assignment of the flat.
- 11.12 She did not contribute any money towards the purchase of the subject property, nor did she receive any money after the flat was sold. She did not even know they had sold it.

### Cross-examination

- 11.13 She was born on 26 October 1972. She went to Canada to study in 1991. She went to high school first and then she went to university.
- 11.14 Her parents divorced almost sixteen years ago. After the divorce she lived with her natural mother. There are one brother and one sister from her natural mother. Her brother is younger than her while her sister is older. All three children lived with their mother all along before she went to Canada.

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- 11.15 Before she went to Canada, she had never lived with her father and the first Taxpayer. Her father paid for her studies. During the five years' study in Canada, she returned to Hong Kong twice. When she returned to Hong Kong she lived with her own mother. She came back to Hong Kong after her graduation in August 1995. When she came back for holidays, she also lived with her own mother.
- 11.16 When she was in Hong Kong for holidays, she visited her father and the first Taxpayer. She would visit her father in his office and they would go out for dinner. When she came back in August 1995, she lived with her own mother again. She was in Kowloon at the time and then she moved to the New Territories. She lived with her mother, her younger brother and one maid. During August 1995 to December 1996 she did not move out of her mother' s house.
- 11.17 After her return to Hong Kong, sometimes she taught the first Taxpayer' s children their homework and sometimes took them out at week-ends.
- 11.18 Several months before she signed the paper she already knew her name was going to be on it. Her father had told her his idea.
- 11.19 On the first occasion when she was told that her father was going to buy a property in her name or in the name of her stepmother, only her father and she were present.
- 11.20 She and her father had a first discussion and quickly thereafter she discussed the matter with her mother and her best friend.
- 11.21 Her father was planning for them to live together. At that moment their relationship was good and his plan was that they would live in the same house, including her, her father, the first Taxpayer, his family, but not including her mother.
- 11.22 She had no preferences about the idea of all living together. It was her father' s idea that she was to take care of the younger brothers and sister, and she had to accept it. All this took place in 1995, after the sale.
- 11.23 It was after the signing of the papers, after completion of purchase that her mother and her friend suggested she should have a property in her own name.

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- 11.24 Her father told her he was afraid of the height because it was on the seventh floor. Before the purchase, they looked at the floor plan and they did have discussion.
- 11.25 Before signing the paper to purchase the subject property in October 1995, she and her father went around the estate to check the environment. She thought that it was a good place. Her father thought so too. He took her to check around when it was still under construction.

### **Mr D' s testimony**

- 12. Mr D' s testimony may be summarised as follows:
  - 12.1 He is the proprietor of Company E and the first and second Taxpayers are respectively his wife and daughter.
  - 12.2 In late 1995, the two Taxpayers and he went to look at the subject property. Before the purchase of the property, he mentioned to his wife and daughter that he was going to use their names as the owners of the property so they could live together. The intention was that he hoped the second Taxpayer could take care of his wife and children and work for him.
  - 12.3 His wife was 39 years old and has a serious illness. And he is not all that healthy either. He hoped that the second Taxpayer could take care of his business. He discussed the matter with his wife and daughter. At first the second Taxpayer accepted his suggestion and the first Taxpayer has no objection. When they went to look at the property before the purchase, the second Taxpayer had already accepted this suggestion.
  - 12.4 In April or May 1996, the second Taxpayer and he had differences over the property. She requested him to buy a property in the names of herself and her girlfriend who was her classmate. He was to pay the downpayment and her classmate was to pay the instalments. He objected, because her friend had a different surname. He could only accept the suggestion that he should pay the downpayment while the second Taxpayer was to pay the instalments. Around May 1996, the second Taxpayer returned to Hong Kong from Japan and she disappeared. He could not reach her for two months. He had gone to Japan to discuss her suggestions before May 1996, but they could not reach a conclusion. Her behaviour made him lose his confidence in her.

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- 12.5 He was afraid that the second Taxpayer might change the property name and discussed the matter with his lawyer. Finally in July 1996, he was able to reach her, and she agreed to sign an authorisation to let him sell the property and he sold it.
- 12.6 He never thought of transferring the subject property into his own name. Further, he has height phobia and seventh floor was already quite high for him. He was also afraid that his children might have some accident. So he did not like to live on the seventh floor. His children were very young, only a few years old.
- 12.7 In 1995, when they went to see the property, they could not view the property. He did not know that complete windows, French windows with nothing on the outside, were going to be used.
- 12.8 What made him like the property so much when he went to see it for the first time in October 1995 was the environment with fresh air and quietude, and down town was highly accessible.

In cross-examination

- 12.9 [Mr D was shown letters written by tax representative Company F purportedly on behalf of both his wife and his daughter to the Revenue, and was asked whether he had seen them before.]

He had not. He had a look only during the hearings before the Board. His wife had mentioned it but he did not take it too seriously. At that time the tax representative did not show him the letters prepared by them.

- 12.10 [Mr D was referred to one of the letters marked ' 34' which reads:

' The property was acquired with the intention for own residential accommodation for Ms B.

On the decision of Ms B' s parents not going to live with her in future, they then decided to acquire a flat for her.' ]

He has seen this letter for the first time right now. Company F is the regular accountant of his company. All the details are discussed by his wife with this consultant. He thinks his wife has an idea of the differences between his daughter and himself and he thinks she knows the intention in purchasing this property. His wife was involved in the whole process. Therefore, regarding



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this case, his wife discussed all the details with Company F and they replied to all the correspondence. As to letter 34, he would like his wife to explain it. Company F is still their consultant, but it was not suggested that they should represent the Taxpayers in this appeal. He had no input into any of these letters.

- 12.11 [He was shown the statement filed by the first Taxpayer for use in this appeal.]

His wife and he had no discussion on this, but before this hearing his wife showed it to him. He read it because it is in Chinese. It is quite true. It cannot really fully reflect his own ideas because of the way of expression, but generally speaking, it is true.

[He was referred to the part of the statement which is translated as follows:

‘ During that time, Mr D thought that as he grew old he decided to buy a flat for his children arising from the two families as their future residence, so that they would have a shelter even when circumstances turned worse.’

He was asked to compare that with his earlier evidence that the flat was for his three children by Ms A, the couple and Ms B only.]

His eldest daughter has already married. The only children he has to take care of are Ms B's younger brother and the other three children of the first Taxpayer and him. He does not have to take care of Ms B because she has already grown up. The only ones he has to take care of are Ms B's younger brother who is only 15 or 16 years old, and the three children of the first Taxpayer.

- 12.12 One day the four children from these two families would move into the flat together with Ms D who would be responsible for this. And he and the first Taxpayer would also move in.

- 12.13 His youngest sons, the twins, were less than two years old. But it is simple. Ms B does not have to think of financial considerations. The only thing she is responsible for is to use the adult way to teach those children. He never thought of having Ms B spending a lot of time looking after the children, but she was going to look after them in a simple way.

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12.14 He has a phobia of heights. When he looked at those complete windows, he was afraid that his children might have accidents. As an adult, he could have the curtains drawn and it would be okay.

12.15 [He was referred to the fact that he rented a flat at Housing Estate C shortly after the assignment of the subject property.]

At that moment the property prices were quite high. Since he liked the environment and the property very much, he decided to rent it. He was lucky to buy another property which is on a lower floor facing a better direction after he had sold the subject property. The price was only a little bit higher.

12.16 He subsequently moved to a flat in Kowloon which is his present residence. The property is held by an investment company which is controlled by him. The purchase of the flat in Kowloon is for the purpose of speculation. The price was around \$10,000,000. It was bought in 1996.

12.17 The subject property was not purchased for speculation. He would not have chosen a property in the New Territories for speculation. He chose the subject property because it was near his place of work.

### **The law**

13. In considering whether an asset is a trading asset or a capital asset, one has to consider the intention which existed at the time of acquisition of the asset. In Lionel Simmons Properties Ltd v CIR 53 TC 461, Lord Wilberforce at page 491 stated:

*‘ One must ask, first, what the Commissioners were required or entitled to find. Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of 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? ... 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 ... 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.’*

And at page 494, his Lordship stated:

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*‘ Frustration of a plan for investment, which compels realisation, even if foreseen as a possibility, surely cannot give rise to an intention to trade.’*

14. In All Best Wishes Ltd v CIR 3 HKTC 750, Mortimer J stated at page 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 produce the answer ... 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. In this case, the onus is on the Taxpayer’s to prove, on a balance of probabilities, that at the time of acquisition of the subject property, their intention (collectively and individually) was to hold it as a capital asset for residential use and that such intention was genuinely held, realistic and realisable.

16. Where a property is owned by more than one person, the intention and the ability to carry it into effect must be proved in respect of each co-owner individually and in respect of all the co-owners collectively (D121/95, IRBRD, vol 11, 183 at page 189).

### **Findings and reasons**

17. Ms B the second Taxpayer was born in 1972. She went to Canada to study in 1991. There she went to high school first and then went to university. In August 1995 she graduated and came back to Hong Kong.

18. Her parents divorced almost sixteen years ago. They have three children. Ms B is the second eldest. She has an elder sister and a younger brother. Before she went to Canada, all three children lived with their mother. When she came back in August 1995, she lived with her mother again.

19. Shortly after her return to Hong Kong, she started to work in her father Mr D’s company, Company E. Sometimes she would teach her stepmother Ms A the first Taxpayer’s children their homework or take them out at week-ends.

20. Ms A was 39 years old and had a serious illness. Mr D was worried about her health and was also worried about his own health.

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21. In late 1995, Mr D, Ms A and Ms B went to look at the subject property. Before the purchase of the property, he told Ms A and Ms B that he was going to put the property into their names. The intention was that they (that is, Mr D, Ms A, their three children and Ms B) should all live together and that Ms B should look after Ms A and her children and take care of Mr D's business. Ms A had no objection to Mr D's plan for living together, and Ms B had accepted it when they went to look at the subject property before the purchase.

22. About two months after the completion of the purchase of the subject property, and on the advice of her own mother and her friend, Ms B suggested to Mr D, as an alternative, that he should buy her another flat in her name only, that he should pay the deposit and that she would be responsible for the instalments. Mr D totally disagreed with the suggestion. They had discussions but could not reach a compromise. The disagreement led to the resignation of Ms B from Mr D's company, Company E. Mr D lost confidence in Ms B's long-term-investment intention towards the subject property on the basis of his plan for living together. In the end Ms B agreed with Mr D that she should relinquish her title as a joint tenant and gave Mr D authority to sell the subject property. It was sold in November 1996.

23. In our view, when acquiring the subject property, the Taxpayers Ms A and Ms B had through Mr D a common long-term-investment intention towards the property on the basis of Mr D's plan mentioned in paragraph 21 above. They therefore acquired the subject property as a capital asset. Subsequently, Ms B's suggestion of the so-called alternative led to a complete breakup of her relations with her father Mr D. The sale of the property marked the frustration of Mr D's plan for a long-term holding which had given rise to the common long-term-investment intention. However, all this did not in our view change the status of the subject property. It had been bought as a capital asset and it was sold as a capital asset. The profit arising from the sale is capital profit and not assessable to profits tax.

24. Our findings of fact are largely based on the testimony of the second Taxpayer Ms B whom we find to be a credible witness. To a much less extent, the testimony of the other witness Mr D was also drawn upon, but there were instances where it was necessary to reject his testimony, as will appear below.

25. Ms A the first Taxpayer through the then tax representative Company F had replied to all the enquiries raised by the Revenue during the objection stage. Briefly her case about the purchase of the subject property was that it was acquired for the residential accommodation of Ms B (see letter '34' in paragraph 12.10 above). That case was abandoned at the hearing of this appeal. Instead she alleged that Mr D decided to buy a flat for his children from the two families as their future residence so that they would have a shelter even when circumstances should turn worse (see her statement filed for use in the appeal in paragraph 12.12 above). She did not give evidence, so her about-turn on the purpose in acquiring the subject property was left unexplained, nor could her statement be substantiated.

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26. When asked to comment on Ms A's reference to the children from the two families, Mr D attempted to come to the rescue by putting forward an explanation. The reference, he said, was not to all the six children consisting of three from his former wife and three from Ms A, but only to the 15-year-old son by the former wife and the two sons and one daughter by Ms A. In other words, Ms B and the eldest daughter by his former wife were not included in the reference. The explanation is obviously futile, because it contradicts his own case (and also Ms B's case) that his plan for living together did not include the 15-year-old son by his former wife. It is a useless attempt to salvage the unsalvageable credibility of Ms A. We are unable to accept the explanation.

27. It was argued on behalf of the Revenue that, in view of the evidence that Mr D had a phobia for the seven-storey-high floor of the subject property, if that was true, neither Mr D, nor the Taxpayers, could have real and realistic intention to hold the property for long-term residential purposes. The evidence is to the effect that Mr D had a phobia for heights and seven storeys were quite high for him. But, as an adult, he would be all right if curtains were drawn (see paragraph 12.15 above). He was concerned that the children might have accidents with the complete windows (extending from ceiling to floor). Before the purchase, he and Ms B looked at the floor plan and had a discussion (see paragraph 11.24 above). Mr D must have learned then about the height of the flat, but that knowledge did not interfere with his acquisition of the flat (in the names of the Taxpayers). After acquisition, Mr D and Ms B went up to the flat several times to plan the decoration. No decoration work was carried out because of the conflict that soon came between them (see paragraph 11.5 above). That comes from the testimony of Ms B which we accept. On the evidence, we are of the view that Mr D's fear of heights and his concern about possible accidents for his children were more apparent than real; they did not affect his or the Taxpayers' intention to acquire and hold the subject property for long-term residential purposes. The plan for living together collapsed, but only because of the irreconcilable differences between Mr D and Ms B.

28. Moving on to the failure of Mr D's plan for living together, we are at once faced with a conflict of evidence between Ms B and Mr D as to the exact nature of the proposition Ms B put to her father, which frustrated his plan (see paragraphs 11.6-7, 11.10 and 12.4 above). Bearing in mind that Mr D's plan was a close family arrangement accessible only to certain members of his immediate family, it is unlikely, in our view, that Ms B would have proposed to him an arrangement having as a principal participant her classmate who was a stranger to the family. She would have been much more likely, we consider, to offer the 'alternative' which we find she did. The conflict of evidence is therefore resolved in favour of Ms B.

### **Conclusion**

29. It follows that this appeal is allowed and that the profits tax assessment under appeal is hereby annulled.