

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D61/03

**Profits tax** – sections 2, 14(1) and 68(4) of the Inland Revenue Ordinance (‘IRO’) – sale of property – intention at the time of acquisition – onus of proof on the taxpayer to show that the intention to invest on capital asset was genuinely held, realistic and realizable – whether or not a quick sale of an asset at a substantial profit is per se indicative of a trading activity.

Panel: Patrick Fung Pak Tung SC (chairman), William Cheng Chuk Man and Daisy Tong Yeung Wai Lan.

Date of hearing: 8 July 2003.

Date of decision: 8 October 2003.

The taxpayer entered into a provisional sale and purchase agreement on 13 November 1999 and a formal agreement for sale and purchase on 17 November 1999 to purchase the Property. Shortly thereafter, the taxpayer signed the provisional agreement for sale and purchase on 22 November 1999 and the formal agreement for sub-sale and sub-purchase on 1 December 1999 to sub-sell the Property. The taxpayer completed the assignment of the Property as a confirmor on 14 December 1999. The taxpayer purchased Property B on 4 March 2000. The assignment was completed on 20 June 2001. The assessor raised profits tax assessment on the purchase and sale of the Property. The taxpayer objected on the ground that the Property was purchased for long term investment.

#### **Held:**

1. In deciding whether a property is a capital asset or trading asset, it is necessary to ascertain the intention of the taxpayer at the time of acquisition of the property. A mere declaration of intention is of limited value. Subjective intention has to be tested against objective facts and circumstances. The intention must be genuinely held, realistic and realizable (Lionel Simmons Properties Ltd v CIR [1980] 1 WLR 1196 and All Best Wishes Ltd v CIR 3 HKTC 750 followed).
2. A quick sale of an asset at a substantial profit is per se more indicative of a trading activity than an acquisition as a long term investment. The difference between the purchase price and the sub-sale price is \$263,000 (that is, 11% of the purchase price). Indeed, such a substantial profit over such a short time already puts the transaction into the ‘suspect’ category. In such circumstances, the taxpayer is

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naturally obliged to put forward convincing evidence to support his allegation that he had acquired the asset as a long term investment.

3. In order to succeed, the taxpayer bears the burden of satisfying the Board on the balance of probability that he did have the intention of acquiring the Property for the purpose of a long term investment and not of a trade at the time of such acquisition. On the Board's view of the totality of the evidence, the Board has come to the conclusion that the taxpayer has not discharged this burden and the Board takes the view that this appeal borders on being frivolous.

### **Appeal dismissed and a cost of \$5,000 charged.**

Cases referred to:

Lionel Simmons Properties Ltd v CIR [1980] 1 WLR 1196  
All Best Wishes Limited v CIR 3 HKTC 750

Ng Yuk Chun for the Commissioner of Inland Revenue.  
Taxpayer in person.

### **Decision:**

1. This is an appeal by the Appellant ('the Taxpayer') against a Profits Tax Assessment for the year of assessment 1999/2000 raised on him. The assessment dated 7 March 2002 was on the basis of Assessable Profits of \$214,123 with Tax Payable in the sum of \$32,118. An objection was lodged by the Taxpayer against such assessment. By his letter dated 22 January 2003, the Respondent ('the Commissioner') made a determination ('the Determination') and rejected the Taxpayer's objection. The Taxpayer has brought the appeal against such determination.

### **The facts**

2. The Taxpayer is a practising solicitor. He conducted his own appeal before us intelligently and with skill.

3. There is no dispute about the basic facts which are adequately set out in paragraph 1 of the Determination as follows:

- '(2) During the years 1999 and 2000, the Taxpayer had owned the following properties:

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- (a) [A flat at Housing Estate A in the New Territories] (“[Property A]”).
  - (b) [A carport at Housing Estate A in the New Territories] (“the Carpark”).
  - (c) [A flat at Housing Estate C] (“the Property”).
  - (d) [A flat at Housing Estate B] (“[Property B]”).
- (3) Property A and the Carpark were acquired by the Taxpayer in the joint names with [Ms W] at \$1,416,450 and \$70,000 on 17 December 1990 and 7 January 1991 respectively.
- (4) (a) By a provisional sale and purchase agreement dated 13 November 1999 (“Appendix A”), the Taxpayer agreed to purchase the Property at \$2,487,000 with the following terms of payment:
- |                  |   |
|------------------|---|
| \$               |   |
| 150,000          | paid upon signing of the provisional agreement on 13.11.1999    |
| 98,700           | payable upon signing of the formal agreement                    |
| 2,238,300        | payable upon completion of the purchase on or before 16.12.1999 |
| <u>2,487,000</u> |   |
- (b) The formal agreement for sale and purchase was signed on 17 November 1999.
- (c) By a provisional agreement for sale and purchase dated 22 November 1999 (“Appendix B”), the Taxpayer agreed to sell the Property at \$2,750,000. The Taxpayer signed an agreement for sub-sale and sub-purchase of the Property on 1 December 1999. The Taxpayer, in the capacity of a confirmor, completed the assignment of the Property on 14 December 1999.
- (5) On 4 March 2000, the Taxpayer signed a memorandum (“Appendix C”) to purchase [Property B] at the price of \$2,299,000. This property was assigned to the Taxpayer on 20 June 2001.
- (6) The Taxpayer supplied the following information in respect of the acquisition and disposal of the Property:

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(a)		\$	\$
	Sale proceeds		2,750,000
	<u>Less:</u> Purchase cost	2,487,000	
	Legal fees on purchase	3,372	
	Stamp duty	37,305	
	Legal fees on sale	200	
	Commission to agent on sale	<u>8,000</u>	<u>2,535,877</u>
	Net Profits		<u>214,123</u>

(b) Reason for selling the Property

“Selling with a view to change for a property with better living environment. A new property, namely ([Property B]) at a price of HK\$2,299,000 was purchased on 4 March 2000 subsequently.”

(7) In reply to the enquiries raised by the Assessor, the Taxpayer claimed that:

- (a) Having worked for more than 20 years, he got sufficient money to finance the purchase of the Property.
- (b) He intended to use the Property as his residence.
- (c) He had been living in [Property A] for 9 years when he acquired the Property.
- (d) He chose the Property as he intended to live near the place of work.

(8) The Taxpayer explained why he considered [Property B] better than the Property in the following terms:

“It came to my awareness (from the title documents) after signing the agreement for sale and purchase that a public right of way (including lift facilities) had to be provided in (the Property) to enable non-residents ... to pass and repass through (the Property) from [Road D] to [Road E] and other parts of [the district where the Property is situated] and that the owners of (the Property) have the responsibility to maintain of the public right of way.

([Property B]) has excellent harbour view, it faces the south direction, it is situated on MTR station, the estate is constructed and managed by the most reputable developers in Hong Kong, the finishes and installations inside the property are of higher class; there are so many prestigious resident-club facilities in the estate.”

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- (9) A consumption record of electricity in respect of [Property B] covering the period from 19 March 2001 to 31 December 2001 supplied by CLP Power Hong Kong Limited is at Appendix D.
- (10) The Assessor considered that the purchase and sale of the Property by the Taxpayer amounted to an adventure in the nature of trade and raised on him the following 1999/2000 Profits Tax assessment:

	\$
Assessable Profits [Fact (6)(a)]	<u>214,123</u>
Tax Payable	<u>32,118</u>

Assessor's Notes:

Assessment issued after considering the following facts:-

- (1) The short period of ownership, you sold the subject property within one month after your purchase.
  - (2) The property was not put to any use by you.
  - (3) You sold the subject property as a confirmor.
- (11) The Taxpayer objected against the 1999/2000 Profits Tax assessment on the ground that the Property was purchased for investment purpose and the sale was a change of investment. He further claimed that:

“In fact all the sale proceeds had been applied for the change of investment.

The matters mentioned in the assessor's note attached to the notice do not change the nature of disposal of the subject property being a change of investment. The length of ownership, the length of enjoyment and the capacity in selling the property are irrelevant factors and will not be taken into consideration when an investor decides to change his investment.

Even if profit tax were payable upon change of investment in the present case, which is not admitted, the quantum assessable should be less than that in the notice by reason of the applicability of personal assessment.”

- (12) The Assessor maintained the view that the Taxpayer's acquisition and disposal of the Property amounted to an adventure in the nature of trade. She invited the Taxpayer to consider withdrawal of the objection and to return a completed election form (“IR76C”) if he intended to elect personal assessment

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for the year. In reply, the Taxpayer refused to withdraw the objection and stated that:

- (a) "... (the Property) was acquired as a capital investment and the subsequent sale of which is for the purpose of change of investment. The view expressed in the assessor's note attached to the notice of assessment is wrong as irrelevant factors had been taken into account and relevant factors had been ignored in formation of such view.
- (b) "As far as the sales and purchases of the completed units in the second-hand property is concerned, you may be right in saying that a prospective purchaser has the opportunity to consider the factors like environment, fung shui and etc. before he decides to buy a property. However, even a purchaser knows the environment of and encumbrances over the land when purchases a property, it does not mean that his subsequent sale of the property in a short time amounts to an adventure in the nature of trade. It is nothing strange for a purchaser to regret on purchasing a property on a second thought immediately after he signs the contract."
- (c) "... (the Property) was not sold in the manner of the sale of a complete unit in the second-hand property market. Prior to the entering into the provisional agreements for sale and purchase of the units in the estate, all prospective buyers could only view a few sample flats on the building site. No prospective buyers were allowed to access to other parts of the estate as building works were still in progress in certain parts of the estate. By reason of this, the prospective buyers could by no means know the public right of way in the estate and the setting aside of the sole garden on ground floor (podium floor level) inside the boundary of the estate as a public sitting-out area when they made site inspection at the material time. The earliest time these matters have come to the purchasers' notice was the time when the title deeds and documents were delivered to their respective solicitors some time after the signing of the formal agreements for sale and purchase."
- (d) "... the developers in Hong Kong would never let the purchasers have the title deeds and documents before they enter into the agreements for sale and purchase."
- (e) "Since it is a term of the agreement for sale and purchase of (the Property) that (the Property) was sold subject to the Deed of Mutual Covenant (which gives the details of the public right of way and the setting

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aside of the ground-floor garden as public sitting-out area but was not a public document in the Land Registry at time of signing of the agreement), the only remedy open to me for dissatisfaction with the public right of way and the public sitting area is to sell (the Property) as soon as possible before these public facilities were put into use or made known to the public at large.”

- (f) “Had the said public facilities been made known to me before I entered the provisional agreement for sale and purchase, I would not have decided to buy (the Property) as I would have seen no reason why I should pay for the living environment of that of a public housing unit with the purchase price of a private unit.”
- (g) “Given that my objection has not yet finally disposed of, it is premature for me to file an IR76C at this stage. In this connection, I hereby specifically reserve my right to file the IR76C in future if the situation warrants.”

- (13) A copy of the floor plans L1 to L6 and salient points as printed in the sale brochure of the Property is at Appendix E.
- (14) The Taxpayer reported in the 1999/2000 Tax Return-Individuals the following particulars of income from employment:

<u>Name of employer</u>	<u>Capacity employed</u>	<u>Period</u>	<u>Income</u>
			\$
[Messrs X]	Assistant Solicitor	1.4.99-30.5.99	68,475
[Messrs Y]	Consultant	1.6.99-27.8.99	12,622
[Messrs Z]	Consultant	1.9.99-31.3.2000	<u>2,086</u>
		Total	<u>83,383'</u>

4. The Taxpayer gave evidence on affirmation to support his own case. He was the only witness called. He gave evidence on factual matters in addition to what has been set out above. We shall deal with the same below.

### **The issue**

5. There is only one issue in this appeal. It arises out of section 14 of the IRO.
6. Section 14(1) of the IRO reads as follows:

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*‘Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.’*

7. Section 2 of the IRO defines ‘trade’ to include:

*‘every trade and manufacture, and every adventure and concern in the nature of trade.’*

### **The law**

8. The law on the interpretation and application of sections 14(1) and 2 of the IRO regarding ‘trade’ and ‘trading asset’ is well settled in both England and Hong Kong.

9. First, in deciding whether a property is a capital asset or trading asset, it is necessary to ascertain the intention of the taxpayer at the time of acquisition of the property. In Lionel Simmons Properties Ltd v CIR [1980] 1 WLR 1196, Lord Wilberforce at page 1199 said:

*‘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?’*

10. Secondly, a mere declaration of intention is of limited value. Subjective intention has to be tested against objective facts and circumstances. The intention must be genuinely held, realistic and realizable. In All Best Wishes Limited v CIR 3 HKTC 750, Mortimer, J said 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 realizable, 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. 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*



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*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.'*

11. In fact, the abovementioned two cases were also cited by the Taxpayer in argument. We shall be guided by these principles when we come to consider the evidence.

### **The case of the Taxpayer**

12. The Taxpayer affirmed in evidence and argued that, at the time of the purchase of the Property, his intention was to hold it as a long term investment.

13. The circumstances according to the Taxpayer under which he had a change of intention after the purchase of the Property and under which he purchased Property B are set out in the skeleton submissions of the Appellant as follows:

- ' 9. The Appellant has been working in Central since 1993. It took the Appellant at least one hour to travel from the Second Property to his office each day. The Appellant needed first taking a taxi from the Second Property to ... Railway Station, then he took a train for Kowloon Tong where he changed for MTR for Central.
10. Some time in November 1999 it came to the Appellant's notice that an new estate called [Housing Estate C] in [the district where the Property is situated] was put on market. Intending to live near his office, the Appellant thus made a visit to the sample flats in the estate.
11. At the time of the said visit, all the sale brochures had already been distributed out and the Appellant could only obtain the price list.
12. Since it only takes 15 minutes to travel from the estate to the Appellant's office and the purchase prices of the units are reasonable, the Appellant therefore decided to purchase the subject property in order to save the travelling time and expenses each day.
13. Immediately after entering the preliminary agreement for sale and purchase with the developer, the Appellant telephoned the Mortgage Services Manager of [the Bank], [Mr F], intending to make mortgage arrangement for the subject property. (See Annex C) [Mr F] assured the Appellant that he would have no problem in obtaining a mortgage loan at an interest rate favourable to him.

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14. Before the Appellant submitted documents to the bank for making a formal application for the mortgage loan, the developer sent the title documents of the subject property to the Appellant's solicitors, [Messrs Z]. It was discovered, upon perusal of the title documents, that there is a right of way in the estate to serve [the residents living in the district where the Property is situated], so that they can enter the estate from [Road E] and then walk through the estate towards [Road D] on the other end, and vice versa. (See Annex D and Annex E) In addition, it was also discovered that the garden on the ground level of the estate was designated as a public sitting-out area. (See Annex F)
15. Foreseeing that the said public right of way and public sitting-out area would bring security and noise problems, the Appellant came to a conclusion that the subject property was not an ideal place to live. The Appellant therefore decided to sell the subject property as soon as possible before the said public right of way and public sitting-out area came to the awareness of the general public.
16. After the completion of the sale of the subject property in December 1999, the Appellant continued to keep an eye on new estates which are of a short travelling-distance from his office and are with good living environment.
17. In January or February 2002, the Appellant identified a suitable new estate which is [Housing Estate B] in Kowloon and decided to buy [Property B] ("the Present Property") because the estate is at side of a MTR station and it takes about 25 minutes to travel from the estate to Central. The other reason why the Appellant bought the Present Property is there being excellent harbour view for the Present Property and high class club-house facilities in the estate. (See Annex G)

### **Our conclusion**

14. To begin with, a quick sale of an asset at a substantial profit is per se more indicative of a trading activity than an acquisition as a long term investment. Here, the Taxpayer signed the provisional sale and purchase agreement on 13 November 1999 and the formal agreement for sale and purchase on 17 November 1999 to purchase the Property. Shortly thereafter, he signed the provisional agreement for sale and purchase on 22 November 1999 and the formal agreement for sub-sale and sub-purchase on 1 December 1999 to sub-sell the Property. The Taxpayer completed the assignment of the Property as a confirmor on 14 December 1999. The difference between the purchase price and the sub-sale price is \$263,000 (that is, 11% of the purchase price). Indeed, such a substantial profit over such a short time already puts the transaction into the 'suspect' category. In such circumstances, the Taxpayer is naturally obliged to put forward

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convincing evidence to support his allegation that he had acquired the asset as a long term investment.

15. Having considered all the evidence, we are not convinced that the Taxpayer acquired the Property with the intention at the time that it should be a long term investment. We set out our main reasons below.

16. First, we find it difficult to accept that the Taxpayer would buy a flat as his own residence without having inspected it and without having seen the sale brochure but was content just to see the show flat. The sale brochure produced at the hearing of the Appeal shows quite clearly the right of way in question.

17. Secondly, we find it difficult to accept that the Taxpayer did not inspect the surroundings of the estate which must have made it obvious to any reasonably intelligent person, especially a solicitor, that there could be a public thoroughfare in fact between Road D and Road E through the estate and that the sitting-out area could be available to members of the public.

18. Thirdly, the location of the replacement property, that is, Property B, hardly supports the allegation of the Taxpayer that his purchase of the Property was prompted by his wish to save travelling time and expenses and to live near his office in Central. This point is aggravated by the fact that the MTR station near Property B was not going to come into use for quite a long time.

19. Fourthly, the electricity bills for Property B show that that property could not have been occupied very often.

20. Fifthly, although given an opportunity, the Taxpayer did not give an explanation or any reasonable explanation as to why he suddenly wanted to live away from Ms W (described as his 'friend') who was still living in Property A which was purchased in their joint names as tenants-in-common in 1990.

21. Last but not least, when the appeal was adjourned, the Taxpayer was asked to look for the solicitors' correspondence regarding the supply of title deeds and documents in respect of his purchase of the Property. As a solicitor, the Taxpayer could not have failed to realize that proof of his claim that he at once changed his mind about the Property upon seeing the title deeds and documents which referred to the right of way in question depended very much upon the correspondence about the supply of title deeds and documents in the process of conveyancing. By a letter dated 19 July 2003, the Taxpayer notified the Clerk to the Board 'that the subject file containing the said correspondence had been put away and that attempts to locate the same are of no avail'.

22. Section 68(4) of the IRO provides that:

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*'The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'*

23. In order to succeed, the Taxpayer (and not the Commissioner) bears the burden of satisfying us on the balance of probabilities that he did have the intention of acquiring the Property for the purpose of a long term investment and not of a trade at the time of such acquisition.

24. On our view of the totality of the evidence, we have come to the conclusion that the Taxpayer has not discharged this burden. Further, we take the view that this appeal borders on being frivolous.

25. Accordingly, we dismiss the appeal of the Taxpayer and confirm the Determination by the Commissioner that the Assessable Profits in respect of the Taxpayer for the year of assessment 1999/2000 are \$214,123 with tax payable in the sum of \$32,118.

26. We further order the Taxpayer to pay the costs of the Board in this appeal in the sum of \$5,000.