

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D64/01

Profits tax – property – whether for the purpose of trade.

Panel: Patrick Fung Pak Tung SC (chairman), Mohan Bharwaney and Michael Neale Somerville.

Date of hearing: 8 June 2001.

Date of decision: 7 August 2001.

The taxpayer bought a property and sold it in about one month with profits. The taxpayer claimed that he bought the property for his parents-in-law to live in on their return from Canada. However, they found it too small. The taxpayer had to sell it.

Held:

1. The taxpayer had not consulted his parents-in-law before he bought the property. He gave inconsistent statements of the purpose of buying the property. He sold the property shortly after he had bought it. He had other property transactions.
2. The Board found the taxpayer bought the property for the purpose of trade.

Appeal dismissed.

Cases referred to:

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

Cheung Mei Fan for the Commissioner of Inland Revenue.
Taxpayer in person.

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Decision:

1. This is an appeal by the Taxpayer against a profits tax assessment for the year of assessment 1996/97 raised on him. An objection was lodged by the Taxpayer on 24 September 1999 against such assessment. By his letter dated 1 February 2001, the Commissioner made a determination and rejected the Taxpayer's objection. The Taxpayer has brought this appeal against such determination.

The facts

2. The Taxpayer was at all material times and is a police inspector.

3. The Taxpayer and his wife, Madam A married on 26 December 1995. They have two children, one born on 7 December 1996 and the other on 1 January 1998.

4. The Taxpayer was provided with staff quarters at Address B. Such staff quarters had an area of 1,200 square feet consisting of three bedrooms, one living room, one dining room, one servant's room, one kitchen and two toilets.

5. The subject matter of this appeal is a property at Address C ('the Subject Property'). The Subject Property was a studio type flat with an area of about 400 square feet.

6. By an agreement for sale and purchase dated 27 January 1997, the Taxpayer agreed to purchase the Subject Property at a consideration of \$1,570,000. By an agreement for sale and purchase dated 5 March 1997, the Taxpayer agreed to sell the Subject Property for a consideration of \$1,850,000. The Taxpayer acted as a confirmor in the assignment of the Subject Property to the ultimate purchaser on 15 March 1997.

7. Apart from the Subject Property, the Taxpayer had engaged in, inter alia, the following property transactions:

| Location | Purchase | Sale |
|----------------|-------------------------------------|-------------------------------------|
| | (a) Agreement for sale and purchase | (a) Agreement for sale and purchase |
| | (b) Assignment | (b) Assignment |
| | (c) Purchase price | (c) Purchase price |
| Address D | (a) 19-6-1996 | (a) 28-11-1996 |
| ('Property 1') | (b) 20-7-1996 | (b) 10-1-1997 |

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| | | |
|------------------|-----------------|-----------------|
| | (c) \$2,030,000 | (c) \$2,370,000 |
| Address E | (a) 23-5-1997 | (a) 1-8-1997 |
| (' Property 2') | (b) 25-7-1997 | (b) 15-8-1997 |
| | (c) \$2,750,000 | (c) \$3,350,000 |
| Address F | (a) 20-8-1997 | (a) 17-2-2000 |
| (' Property 3') | (b) 16-9-1997 | (b) 14-3-2000 |
| | (c) \$2,800,000 | (c) \$1,520,000 |

8. In reply to a questionnaire issued by the assessor concerning the purchase and sale of the Subject Property, the Taxpayer asserted on 6 December 1997 as follows:

- (a) The Subject Property was purchased for use as residence for his parents-in-law when they returned to Hong Kong after their emigration.
- (b) The Subject Property was sold because it was too small as his brother-in-law was also returning to Hong Kong.
- (c) The proceeds derived from the sale of the Subject Property were used to purchase Property 3.
- (d) Property 3 was acquired for use as his residence.

9. The Taxpayer stated that he derived a gain of \$204,550 from the sale of the Subject Property which was computed as follows:

| | | |
|--|---------------|-----------------------|
| | \$ | \$ |
| Sale proceeds | | 1,850,000 |
| <u>Less:</u> Purchase consideration | | <u>1,570,000</u> |
| | | 280,000 |
| <u>Less:</u> Legal fees on purchase and sale | 23,000 | |
| Stamp duty | 18,250 | |
| Commission to agent (purchase and sale) | <u>34,200</u> | |
| | | <u>75,450</u> |
| Net profits | | <u><u>204,550</u></u> |

10. The assessor was of the view that the purchase and sale of the Subject Property by the Taxpayer amounted to an adventure in the nature of trade. He therefore raised on the Taxpayer the following profits tax assessment for the year of assessment 1996/97:

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| | |
|---------------------|-----------------------------------|
| | \$ |
| | <u>Assessable</u> profits 204,550 |
| Tax payable thereon | <u>30,682</u> |

11. By letter dated 24 September 1999, the Taxpayer objected against the above assessment in the following terms:

- ' (a) The purpose of buying [the Subject Property] is for self use with no business intention;
- (b) The statutory requirement for stamp duty and rates were complied with;
- (c) The so-called "profit" was not a big amount that deserve being treated as business gain;
- (d) There is no evidence of having a profiteering mens rea of making a profit. In fact, a professional or even amateur property trader will make use of a shell company to evade such profit [sic] tax and minimize transaction costs such as stamp duty;'

12. In response to the assessor's enquiries, the Taxpayer in his letter dated 16 October 1999 put forward the following allegations and contentions:

- (a) The reason for choosing the Subject Property was that 'the small size (400 square feet) was found suitable for retired couple.'
- (b) The reason for selling the Subject Property was that 'father/mother-in law objected living in small premise as they were accustomed to living in "big house" overseas.'
- (c) The Subject Property was one of '400 square feet studio type, open kitchen no bedroom'.
- (d) His parents-in-law emigrated to Canada in 1987 and they planned to come back to Hong Kong in 1995. Their plan to come back had never materialized.
- (e) The intended usage of Property 3 was 'for self use or use by mother/father-in-law'. It was left vacant because his parents-in-law finally refused to live there.
- (f) He was currently arranging judicial separation with Madam A.

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13. By a letter dated 20 December 1999, the Taxpayer claimed that:

‘ I have verbally consulted [my parents-in-law] in phone that a place would be available for occupation once they come back to Hong Kong. I did not mention whether I would purchase or rent a place for occupation. Nor did I mention the size of the place. I only told them that the place would be close to my quarter.’

14. The Taxpayer also put forward the following arguments in his letter to the Inland Revenue Department (‘ IRD’) dated 29 May 2000 to support his claim that the purchase and sale of the Subject Property was not a trading transaction:

(a) ‘ The fact that the “proceeds” from disposing [the Subject Property] was spent in [Property 3] means that all “proceeds” were in fact vaporized.’

(b) ‘ ...I was owning one property during your review period.’

15. In declining to withdraw the objection, the Taxpayer, by letter dated 25 August 2000, put forward the following further contention:

‘ [The Subject Property] was originally purchased for intention of own use and its size (about 400 square feet) is suitable for me who just married with no children. However, since purchase for one month. [sic] In view of the forthcoming larger family size, we decided to give up said premise for a larger one and the aforesaid said [sic] would be an alternative use by my ex-parents-in-law. However, due to unforeseeable [sic] circumstances, such property was not occupied by them.’

It should be noted that as at the date of the agreement for sale and purchase of the Subject Property (27 January 1997), the first child of the Taxpayer had been born.

The notice of appeal

16. The Taxpayer gave evidence on oath at the hearing of the appeal. According to him, the process of appeal to this Board was commenced by his writing a letter dated 23 February 2001 to the Clerk to the Board of Review (‘ the Clerk’) which he sent off by ordinary post. The letter was apparently not received by the Clerk nor was a copy received by the IRD.

17. It is important to note that the caption of that letter contains the following words:

‘ Seeking for adjournment [sic] for final appeal to Appeal Board’

And that paragraph 2 thereof reads as follows:

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- ‘ 2. Please be informed that I am still considering lodging [*sic*] an appeal to the board of review. Before I make my determination, grateful if you could advise me the following matters (that is, please do not treat this letter as a formal notice of appeal to the board of review):’ .

The letter then goes on to address a number of queries to the Clerk.

18. According to the Taxpayer, after he had received the demand for tax from the Commissioner, he was very surprised and telephoned a Miss Ko of the IRD to make inquiries. Eventually on 3 April 2001, the Taxpayer faxed to the Clerk a copy of the said letter dated 23 February 2001 but with paragraph 2 thereof amended to read as follows:

- ‘ 2. Please be informed that I am lodging [*sic*] an appeal to the board of review. Grateful if you could advise me the following matters (that is, please treat this letter as a formal notice of appeal to the board of review):’ .

19. At the hearing of the appeal, the representative of the Commissioner took the point that the appeal by the Taxpayer was out of time.

20. We decided to hear argument by the parties on both the time point and the merits of the appeal.

Our conclusion on the time point

21. Section 66 of the Inland Revenue Ordinance (‘IRO’) provides as follows:

‘66. Right of appeal to the Board of Review

(1) Any person (hereinafter referred to as the appellant) who has validly objected to an assessment but with whom the Commissioner in considering the objection has failed to agree may within –

(a) 1 month after the transmission to him under section 64(4) of the Commissioner’s written determination together with the reasons therefor and the statement of facts; or

(b) such further period as the Board may allow under subsection (1A),

either himself or by his authorised representative give notice of appeal to the Board; but no such notice shall be entertained unless it is given in writing to the

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clerk to the Board and is accompanied by a copy of the Commissioner's written determination together with a copy of reasons therefor and of the statement of facts and a statement of the grounds of appeal.

(1A) If the Board is satisfied that an appellant was prevented by illness or absence from Hong Kong or other reasonable cause from giving notice of appeal in accordance with subsection (1)(a), the Board may extend for such period as it thinks fit the time within which notice of appeal may be given under subsection (1). This subsection shall apply to an appeal relating to any assessment in respect of which notice of assessment is given on or after 1 April 1971.

(2) The appellant shall at the same time as he gives notice of appeal to the Board serve on the Commissioner a copy of such notice and of the statement of the grounds of appeal.

(3) Save with the consent of the Board and on such terms as the Board may determine, an appellant may not at the hearing of his appeal rely on any grounds of appeal other than the grounds contained in his statement of grounds of appeal given in accordance with subsection (1).'

22. In the letter of determination by the Commissioner dated 1 February 2001, the provisions of section 66(1), (1A) and (2) of the IRO are set out in extenso.

23. In evidence, the Taxpayer says that the Commissioner did not make it clear that he must lodge an appeal against the determination within a period of one month. We do not think that the Taxpayer, as an experienced police inspector who was able to conduct his appeal in English, could have failed to appreciate the meaning and effect of the said section 66 as drawn to his attention by the Commissioner's letter.

24. Even assuming that the letter dated 23 February 2001 was sent off by the Taxpayer on the same date and that it was received by the Clerk, the same did not constitute a notice of appeal as required under section 66 because it in terms specifically said that it was not a notice of appeal by the Taxpayer. Further the letter does not set out any ground of appeal.

25. In the alternative, on the basis that the said letter dated 23 February 2001 was sent to the Clerk for the first time by fax on 3 April 2001, then there is no doubt that the appeal was lodged out of time. In the circumstances of this case, we do not think that the reasons put forward by the Taxpayer constitutes '*other reasonable cause from giving notice of appeal in accordance with subsection (1)(a)*' within the meaning of section 66(1A) of the IRO so as to enable us to extend the time for the Taxpayer to lodge his appeal.

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26. The above is sufficient to dispose of the Taxpayer's appeal.
27. We, nevertheless, proceed to deal with the appeal on its merits in case we are wrong on the time point.
28. We should add that we can find no statutory provision under which the Clerk was obliged to answer queries of the sort contained in the letter dated 23 February 2001 which in effect amounted to an attempt to seek legal advice from the Clerk.

Our conclusion on the merits

29. Section 14(1) of the IRO reads as follows:

'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.'

30. Section 2 of the IRO defines 'trade' to include:

'every trade and manufacture, and every adventure and concern in the nature of trade.'

31. At the hearing, Ms Cheung for the Commissioner very helpfully referred us to some propositions of law supported by authorities which we gratefully adopt as follows:

- (a) Intention at the time of acquisition is crucial

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?'

- (b) Subjective intention is to be tested against objective facts and circumstances

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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 realisable. 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 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. 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. Thing 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.’

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

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

33. Thus, 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 Subject Property for the purpose of a long-term investment and not of a trade at the time of such acquisition.

34. We have considered all the evidence, in particular, the following:

- (a) the fact that the Taxpayer had not consulted his parents-in-law before the acquisition of the Subject Property which was allegedly purchased for them to live in on their return from Canada where they were used to living in a big house;
- (b) the inconsistencies in the statement of the purpose of acquiring the Subject Property by the Taxpayer in his representations to the IRD at different stages which are apparent from paragraphs 8, 11, 12 and 15 above;

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- (c) the shortness of the period between the time when the Taxpayer agreed to purchase the Subject Property and the time when he agreed to sell it at a profit resulting in his acting only as confirmor in the transaction;
- (d) the other property transactions the Taxpayer was involved in during the relevant period.

We are not convinced that the Taxpayer did not acquire the Subject Property for the purpose of trade. We are accordingly not persuaded that the Taxpayer has proved that the Commissioner was wrong in his determination.

35. In all the circumstances, we dismiss the appeal by the Taxpayer.