

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D77/01

Profits tax – intention at the time of purchase – whether or not subsequent purchase relevant to determining the intention – section 68(4) of the Inland Revenue Ordinance (‘IRO’) – onus of proof on the taxpayers.

Panel: Audrey Eu Yuet Mee SC (chairman), John Lee Luen Wai and Horace Wong Ho Ming.

Dates of hearing: 6 and 20 August 2001.

Date of decision: 7 September 2001.

From 1985 to 1998, four properties were owned by one or both of the taxpayers. These four properties were sold subsequently and gave rise to the gains on disposal. The Inland Revenue Department (‘IRD’) raised property tax assessment in respect of the four properties. The taxpayers objected to such assessment. The taxpayers claimed that the purchase of the four properties was for self use.

Held:

1. In considering whether there is a trading profit or a capital gain, the Board must ascertain the intention, which existed at the time the relevant property was acquired. The gain or profit might subsequently be used to acquire a capital asset now held at a loss. Such subsequent purchase was not irrelevant for its purpose. Whatever sympathies the Board felt for the taxpayers who are now caught in the property downturn, this cannot affect the Board’s consideration of their intention at the time they acquired the four properties in question.
2. It is provided under section 68(4) of the IRO that the onus is on the taxpayers to persuade the Board that the determination was erroneous.
3. The Board has closely observed the demeanour of the taxpayer and does not believe his evidence that the four properties were for self use.

Appeal dismissed.

Chow Cheong Po for the Commissioner of Inland Revenue.

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Taxpayers in person.

Decision:

The appeal

1. The Taxpayers appeal against the determination of the Commissioner of Inland Revenue dated 12 April 2001 in respect of the profits tax assessment raised on them for the years of assessment 1990/91, 1991/92 and 1993/94. The Taxpayers claim that the gains they made from the sale of four properties during the material period were capital in nature and not assessable to tax.

2. The four properties in this appeal were called in short, Properties 1, 2, 3 and 4. As the evidence covered a total of 16 properties, including these four, which were owned by one or both of the Taxpayers between the years from 1985 to 1998, the simplest way is to attach to this decision two charts: Chart I being exhibit 1 submitted by the IRD giving the respective code and the particulars of the 16 properties and Chart II being exhibit 3 submitted by the IRD showing by time sequence when one or both of the Taxpayers held these 16 properties.

The facts

3. The following facts were not in dispute.

4. The Taxpayers are husband and wife. They were both government employees during the material period. The husband Mr A was described as clerical officer II working in Department B. The wife Madam C was a technical officer working with Department D.

5. Details of the Taxpayers' employment income were as follows:

Year of assessment	Mr A	Madam C
	\$	\$
1991/92	132,191	185,649
1992/93	147,944	206,820
1993/94	163,565	228,840
1994/95	180,092	251,460

6. Properties 1, 2, 3 and 4 were purchased and sold on the dates as shown in the Charts attached hereto and gave rise to the following gains on disposal.

	Property 1	Property 2	Property 3	Property 4
	\$	\$	\$	\$
Sale proceeds	1,330,000	3,030,000	3,780,000	3,960,000

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<u>Less: Purchase price</u>	<u>751,900</u>	<u>2,430,000</u>	<u>2,299,800</u>	<u>3,458,000</u>
Gross profit	578,100	600,000	1,480,200	502,000
 <u>Less: Expenses</u>				
Legal fee on				
Purchase and sale	5,070	--	51,370	2,100
Overdue interest to				
Vendor	(1)59,886	--	--	--
Stamp duty	--	--	63,244	98,355
Management fee	2,550	--	5,736	--
Rates	3,725	--	3,000	--
Line up fee	20,000	--	--	--
Bank interest	--	--	220,692	--
Decoration	--	--	275,000	--
Agent' s fee	--	--	--	3,000
Miscellaneous	20,000	100,000	1,357	--
Utilities	--	--	3,100	--
	<u>111,231</u>	<u>100,000</u>	<u>623,499</u>	<u>103,455</u>
Profit on disposal	<u>466,869</u>	<u>500,000</u>	<u>856,701</u>	<u>398,545</u>

(1) For the period from 20 March 1990 to 18 August 1990

7. In August 1997, the Taxpayers received profits tax assessments showing that they were assessed to nil profits tax for the relevant years. However, the IRD later changed its mind and raised property tax assessment in respect of the four properties. The Taxpayers objected to such assessment. At one time, the IRD was ready to make a without prejudice offer to the Taxpayers to settle the dispute. Unfortunately the Taxpayers did not accept the offer at the time. Despite the Taxpayers' indication that they are now willing to accept the offer, Mr Chow for the IRD was no longer willing to compromise on the same terms. We mention this as this was repeatedly emphasized by Mr A as one of his grievances and one of his reasons for this appeal.

8. As the offer was not accepted, the Commissioner of Inland Revenue gave his determination on 12 April 2001 assessing profits tax as set out in paragraph 6 above. The Taxpayers bring this appeal.

The evidence

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9. Mr A was the only witness. He gave evidence on behalf of both Taxpayers. He did not deny any of the property transactions set out in the two Charts attached hereto.

10. The first property in time sequence as shown in Chart II was Property 8. This was a flat held under the home ownership scheme. This means that the Taxpayers purchased it from the Housing Authority at a discount below its market value. After five years, the flat could be surrendered to the Housing Authority at its original purchase price. After ten years, it could be sold at the market but a premium would have to be paid to the Housing Authority. Since Property 8 was purchased in June 1985, the first five years would expire in June 1990.

Property 1

11. The Taxpayers purchased Property 1 on 6 February 1988. At the time the property was still under construction. The Taxpayers claimed that they intended to acquire Property 1 for self use. They believed that the property would be ready for completion by the end of 1990 and they could rely on the financial assistance under the home purchase scheme available to government servants. However, the completion came earlier in the year and they had to sell Property 1 even before they made an application under the scheme.

12. Every year, the government would issue a circular to government servants inviting applications to the home purchase scheme. Mr A explained that since he started work for the government in 1966, he would be eligible under the scheme by December 1990. He estimated that Property 1 would be ready for completion by then. He first made an application under the home purchase scheme on 2 October 1990, after Property 1 was sold. He was given approval in principle on 5 November 1990. On 19 November 1990, he applied to transfer his benefit to his wife who would also be eligible under the home purchase scheme as an alternative but not in addition to him. On 10 December 1990, Madam C was given approval in principle. At the time, the Taxpayers intended to use the funds under the home purchase scheme for Property 16. However, in April 1991, the Taxpayers applied to withdraw from the home purchase scheme as they were unwilling to surrender their home ownership flat, Property 8. Such surrender was a condition under the scheme.

13. To return to Property 1, it was ready for completion in March 1990. Mr A wrote to the developer to ask for extension of time. In his letter dated 1 April 1990 to the developer, he explained that he could finance the balance of the purchase price from a mortgage of the property, however he could not pay the solicitors fees and the stamp duty. There was no mention of the home purchase scheme. The developer replied by a letter dated 9 April 1990 granting an extension of time to 15 May 1990 on various conditions including the payment of interest. By another letter dated 15 July 1990, Mr A asked for further extension of time. He said he was still in difficulties with the payment of solicitors fees and stamp duty as he had recently paid his nephew \$48,000 to support him in continuing his studies in Canada. By a letter dated 14 August 1990, the developer

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formally rejected any further extension. Mr A said that he was orally informed of this decision on 10 August and they sold Property 1 on 11 August 1990 as confirmors prior to completion.

14. Mr A produced a bank slip to show that he paid \$100,000 to his nephew on 12 August 1989. He explained that this made it financially difficult for him to complete the sale of Property 1. Since it was a forced sale, it was not really a trading for profit.

15. As appears from the Charts, the Taxpayers purchased five properties in 1989, in particular, even after giving \$100,000 to his nephew on 12 August 1989, the Taxpayers purchased three more properties namely Properties 12, 13 and 14 in October and November 1989. Mr A was asked to explain why he should purchase these three additional properties when he claimed that he was unable to pay for the solicitors fees and stamp duty on completion of Property 1. He said it was a difficult question to answer and he did not really answer it.

16. Further as appears from the Charts, the Taxpayers purchased Property 9 on 18 June 1988, about four months after they purchased Property 1. In a letter dated 28 August 1991 to the IRD, the Taxpayers claimed that they purchased Property 9 for self use. Mr A was asked to explain why they purchased Property 9 also for self use when they had just purchased Property 1 for self use. Mr A could not really give any answer. He tried to say that Property 9 was 'claimed' to be for self use when in fact it was for rental. But when pressed, he reverted to saying it was for self use. Property 9 was soon sold in January 1989.

17. If Property 1 was for self use and was intended to be financed by the home purchase scheme as alleged, it was a condition under the scheme that the Taxpayers would sell Property 8, the home ownership scheme flat. Since by then, the flat had been held for less than ten years, the Taxpayers could only surrender it to the Housing Authority for return of the original price. Since property price was going up at the time, such surrender would have meant a loss to the Taxpayers. There was no evidence that the Taxpayers tried to do so. In fact they later withdrew from the home purchase scheme for the very reason that they were not willing to surrender Property 8. It was not until 1996, after they held Property 8 for over ten years that the Taxpayers again applied for the home purchase scheme. They were entitled to keep Property 8 upon payment of the premium to the Housing Authority, which they did. Mr A explained that they were looking for other properties for self residence as they did not like Property 8; there was air pollution from the industries and chimneys nearby. However, they have not sold Property 8 and still keep it to date.

Property 2

18. Property 2 was purchased on 16 August 1991. Mr A said he did not view the property. On the day before the purchase, the typhoon signal was up and he could not visit the site. On the next day, it was raining heavily and they purchased the flat on the recommendation of the estate agent.

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19. Mr A also said that the intention was to claim under the home purchase scheme. This was said orally when giving evidence and also in the Taxpayers' letter dated 3 September 2000 to the IRD. As stated above, the Taxpayers withdrew from the home purchase scheme in April 1991. There was no evidence that they renewed the application until 1996 when, by then, they had held Property 8 for over ten years.

20. The Taxpayers claimed that they intended the property for self use. However, they subsequently discovered that it was next to a clay factory and this would be damaging to the eyes of Madam C. They relied on a doctor's memo in 1985 to show that Madam C had a long standing eye problem.

21. The Taxpayers sold Property 2 in March 1992, about eight months after its purchase. They never took possession of the flat and sold as confirmors.

Property 3

22. The Taxpayers purchased this property on 8 September 1991, less than a month after they purchased Property 2. Both were said to be for self use.

23. This time they did complete the purchase. This was on 19 January 1993. Mr A said that the decoration went on for about a month and they commenced residence by the end of February 1993.

24. The IRD produced the records of electricity and water consumption which showed the following.

(a) Water

Date	Meter reading	Consumption m ³	Water charges \$
19-1-1993	0.490		
25-4-1993	1.830	2	--
6-8-1993	3.993	2	--

(b) Electricity

Reading date	Units consumed
1-11-1992	0
19-3-1993	17
22-4-1993	7
20-5-1993	21
18-6-1993	35

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20-7-1993	62
6-8-1993	17

25. Mr A initially made a challenge to the admissibility of such records. However, it is clear from sections 58(1)(c) and (2) of the Personal Data (Privacy) Ordinance as well as sections 51(4)(a) and 52(1) of the IRO that such records are admissible. Mr A also complained that parts of the reply from the Water Supplies Department had been covered up. However, it is clear from the letters produced by the IRD that the covered up parts most probably relate to other periods of time outside the period when Property 3 was held by the Taxpayers. Mr A then confined his arguments to different consumption rate of different people. He also explained that he and his wife were only staying in Property 3 some of the time and not the entire period when they held it. Mr A said he stayed there for four months whilst his wife stayed there for three months. Even during these few months when they were residing there, they were also staying at other flats which were held by them at the time. These included Properties 8, 11 and 16. When asked to explain, Mr A said he would stay in Property 3 for six days in a week and spend time 'looking' or 'visiting' the other flats in turn. By 'looking' or 'visiting' the other flats, he meant that he was residing there. He claimed that all the other flats were also furnished and he would spend time there just as a man who owned several cars would drive different cars at different cars at different times.

26. It is noted that Property 16 was purchased on 4 December 1990, about nine months prior to the purchase of Property 3. Both properties were in the same development, Property 16 was in Phase 1 and Property 3 was in Phase 2 of Housing Estate E. Both blocks were next to the harbour. Mr A said that they took possession of Property 16 and moved in there about one month after they took possession. That would be April 1992. In short, they should be aware of the surrounding circumstances prior to completion of the purchase of Property 3 in January 1993.

27. Mr A claimed that he really liked Property 3. However, his wife did not like it. Although it was on the 18th floor and had a full sea view, it was noisy from the sound of boats and his wife could not sleep. This affected her eyes. He also said that the property was facing a cemetery. As can be seen from exhibit 4, a map produced by the IRD, the cemetery was across the other side of the harbour some distance away. He said this was an eye sore. Again from exhibit 4, it can be seen that Property 16 was much closer to the cemetery than Property 3. Mr A explained that for reasons given, they sold Property 3 in July 1993.

28. The Taxpayers also purchased Property 15 on 6 August 1992. It was prior to the Taxpayers taking possession of Property 3. Yet this property was also claimed to be for self residence as evidenced by Madam C's application under the home purchase scheme. By now it is becoming increasingly difficult to keep track of the many flats all held at the same time and all said to be for self residence.

Property 4

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29. This was purchased by the Taxpayers on 1 May 1992. Mr A said that it was purchased as a residence for his parents-in-law. At about the same time, on 9 May 1992, the Taxpayers purchased another flat in the same development, Property 5. The intention was to live near the parents who were both in their eighties.

30. However, the parents-in-law had not been taken to view the site prior to the purchase. Mr A said there was no need as the parents-in-law knew a about Road F where the site was situated and had no objection initially. In March 1993, when the property was near completion and the parents-in-law went to the site near the main entrance, the parents-in-law did not like it. Road F was said to be too steep. The mother-in-law had slipped twice before and was worried about the marble flooring which she could see from the entrance. They also did not like the view of the Garden G tower which was bad for *fung shui*. As a result, the Taxpayers sold Property 4 in April 1993.

31. Despite the Taxpayers' claim that they intended to live near the aged parents in this development in Road F, only five months after the purchase of Properties 4 and 5, the Taxpayers purchased Property 15 which was in District G in the New Territories, far away from Road F in the Hong Kong Island. They said Property 15 was for self residence. As events turned out, they are now mainly residing in Property 15 (as well as in Property 8) whereas Madam C' s parents are residing in District I in the Hong Kong Island. The had abandoned the intention of residing close together.

General

32. Mr A said that all the gains he made from the various property transactions had been used to purchase the properties which he is still holding either jointly or severally with his wife. Property prices had gone down drastically and he had lost whatever profit made. In fact, they are finding it difficult to cover the mortgage payments. He explained that it was due to such financial difficulties that they were not able to take up the without prejudice offer from the IRD earlier.

The law

33. The law in this area is well settled. In considering whether there is a trading profit or a capital gain, we must ascertain the intention which existed at the time the relevant property was acquired. The gain or profit might subsequently be used to acquire a capital asset now held at a loss. Such subsequent purchase is not irrelevant for our purpose. Whatever sympathies we may feel for the Taxpayers who are now caught in the property downturn, this cannot affect our consideration of their intention at the time they acquired the four properties in question.

34. It is provided under section 68(4) of the IRO that the onus is on the Taxpayers to persuade us that the determination was erroneous.

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Findings and reasons for decision

35. Again it may be unfortunate that the Taxpayers did not take up the without prejudice offer made by the assessors. However, it is not a matter which concerns us. The offer is no longer available and we must apply the law as we find them. We have closely observed Mr A's demeanour and we do not believe him for reasons given below.

Property 1

36. We do not accept that the property was acquired for the reason put forward by the Taxpayers. We find that the Taxpayers did not have any intention to give up Property 8 at that time. The application for the home purchase scheme was only made in October 1990, after Property 1 was sold. Even in the letters to the developer, the Taxpayers never mentioned the home purchase scheme. We do not accept Mr A's evidence that they could not complete the purchase as they could not pay the solicitors fees and the stamp duty. If they were in such financial difficulties, they would not have purchased Properties 12, 13 and 14 in late 1989. The truth was they were trying to delay the completion for as long as possible in the rising market to obtain the best price for resale. They would make a higher profit even after paying interest and other expenses due to the extended completion period. Furthermore, Mr A could not really explain how they could have intended the property for self use when a few months later, they purchased Property 9 also allegedly for self use. We have no doubt that in respect of Property 1, the Taxpayers were trading for profit.

Property 2

37. We do not accept that the property was acquired for the reason put forward by the Taxpayers. If the Taxpayers truly intended to reside in the property, they would not have purchased it on the recommendation of the estate agent without proper consideration of its surrounding circumstances. This is especially when Madam C is said to have an eye problem which needed special attention to the living environment. Further, Property 2 was purchased within a month of Property 3, also allegedly for self use. This was in addition to Properties 8 and 16, also for self use. Such repeated claims of self use stretches our credulity beyond any reasonable limit. Finally, Property 2 was held for a very short period and this is one of the well accepted badges of trade. We have no doubt that in respect of Property 2, the Taxpayers were trading for profit.

Property 3

38. We do not accept that the property was acquired for the reason put forward by the Taxpayers. The electricity and water consumption records show that the Taxpayers did not really reside in Property 3. We do not believe Mr A when he claimed that he and his wife were living from time to time in different flats in the same way as people would alternate between the use of different cars. He claimed to be moving between three or four flats in the course of a few months. He has failed to give any credible reason for doing so. In addition, the Taxpayers also purchased

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Properties 5 and 15 in 1992 also allegedly for self use. If this were true, they would surely be living beyond the means of government servants. The only logical explanation is that they were dealing in the properties hoping for a quick profit in a rising market.

Property 4

39. We do not accept that the property was acquired for the reason put forward by the Taxpayers. If they had truly intended it as a residence for the parents-in-law, they would have taken greater precaution to ensure that the property would be suitable for them. Road F was well known and it is inconceivable that no prior consideration was given to its gradient. They should also have anticipated the problem with the marble flooring which is a usual feature of most modern developments. The presence of Garden G in the area must also have been well known. Further, the Taxpayers purchased Property 15 in District H not long after the purchase of Properties 4 and 5. This shows that the Taxpayers did not truly intend to live with their parents. Property 4 was held only for a very short time and was sold by the Taxpayers as confirmors prior to completion. We have no hesitation in finding that this was another trading activity on the part of the Taxpayers.

Conclusion

40. For all the reasons given, we dismiss the appeal and uphold the determination of the Commissioner of Inland Revenue as to the tax payable.

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Chart I

**Appeal to the Board of Review
by Mr A and Madam C (' the Taxpayers ')
against profits tax assessments - 1990/91, 1991/92 and 1993/94**

Exhibit submitted by the Commissioner' s representative

Exhibit 1: Property transactions done by the Taxpayers

Property	Location	Owner	Purchase	Sale
			(a) Agreement for sale and purchase (b) Assignment (c) Price	(a) Agreement for sale and purchase (b) Assignment (c) Price
8	Address J	the Taxpayers	(a) 8-6-1985 (b) 5-9-1985 (c) \$251,300	
1	Address K	the Taxpayers	(a) [6-2-1988] (b) -- (c) \$751,900	(a) 11-8-1990 (b) 18-8-1990 (c) \$1,330,000
9	Address L	the Taxpayers	(a) [18-6-1988] (b) -- (c) \$981,533	(a) [12-1-1989] (b) -- (c) \$1,148,000
10	Address M	Mr A	(a) 28-1-1989 (b) -- (c) \$1,393,100	(a) -- (b) 18-3-1991 (c) \$1,820,000
11	Address N	the Taxpayers	(a) 15-2-1989 (b) 28-3-1991 (c) \$1,343,600	
12	Address O	Mr A	(a) 6-10-1989 (b) 28-8-1990 (c) \$551,000	(a) 5-8-1991 (b) 22-8-1991 (c) \$1,070,000
13	Address P	Madam C	(a) 1-11-1989	(a) 9-3-1992

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			(b) 16-9-1991 (c) \$1,228,920	(b) 8-4-1992 (c) \$3,030,000
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Property	Location	Owner	Purchase	Sale
			(a) Agreement for sale and purchase (b) Assignment (c) Price	(a) Agreement for sale and purchase (b) Assignment (c) Price
14	Address Q	Mr A	(a) 7-11-1989 (b) -- (c) \$1,132,800	(a) 20-4-1991 (b) 20-6-1991 (c) \$1,480,000
16	Address R	the Taxpayers	(a) 4-12-1990 (b) 16-3-1992 (c) \$1,165,900	(a) 27-1-1995 (b) 2-3-1995 (c) \$2,990,000
2	Address S	the Taxpayers	(a) [16-8-1991] (b) -- (c) \$2,430,000	(a) [2-3-1992] (b) 16-6-1992 (c) \$3,030,000
3	Address T	the Taxpayers	(a) [8-9-1991] (b) 19-1-1993 (c) \$2,299,800	(a) 9-7-1993 (b) 5-8-1993 (c) \$3,780,000
4	Address U	the Taxpayers	(a) [1-5-1992] (b) -- (c) \$3,458,000	(a) [19-4-1993] (b) 25-6-1993 (c) \$3,960,000
5	Address V	the Taxpayers	(a) 9-5-1992 (b) 30-6-1993 (c) \$3,775,000	
15	Address W	the Taxpayers	(a) 6-8-1992 (b) 19-8-1993 (c) \$1,596,000	
6	Address X	the Taxpayers	(a) 26-1-1994 (b) 17-5-1995 (c) \$4,852,000	

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7	Address Y	the Taxpayers	(a) 28-1-1994 (b) 18-7-1994 (c) \$2,760,000
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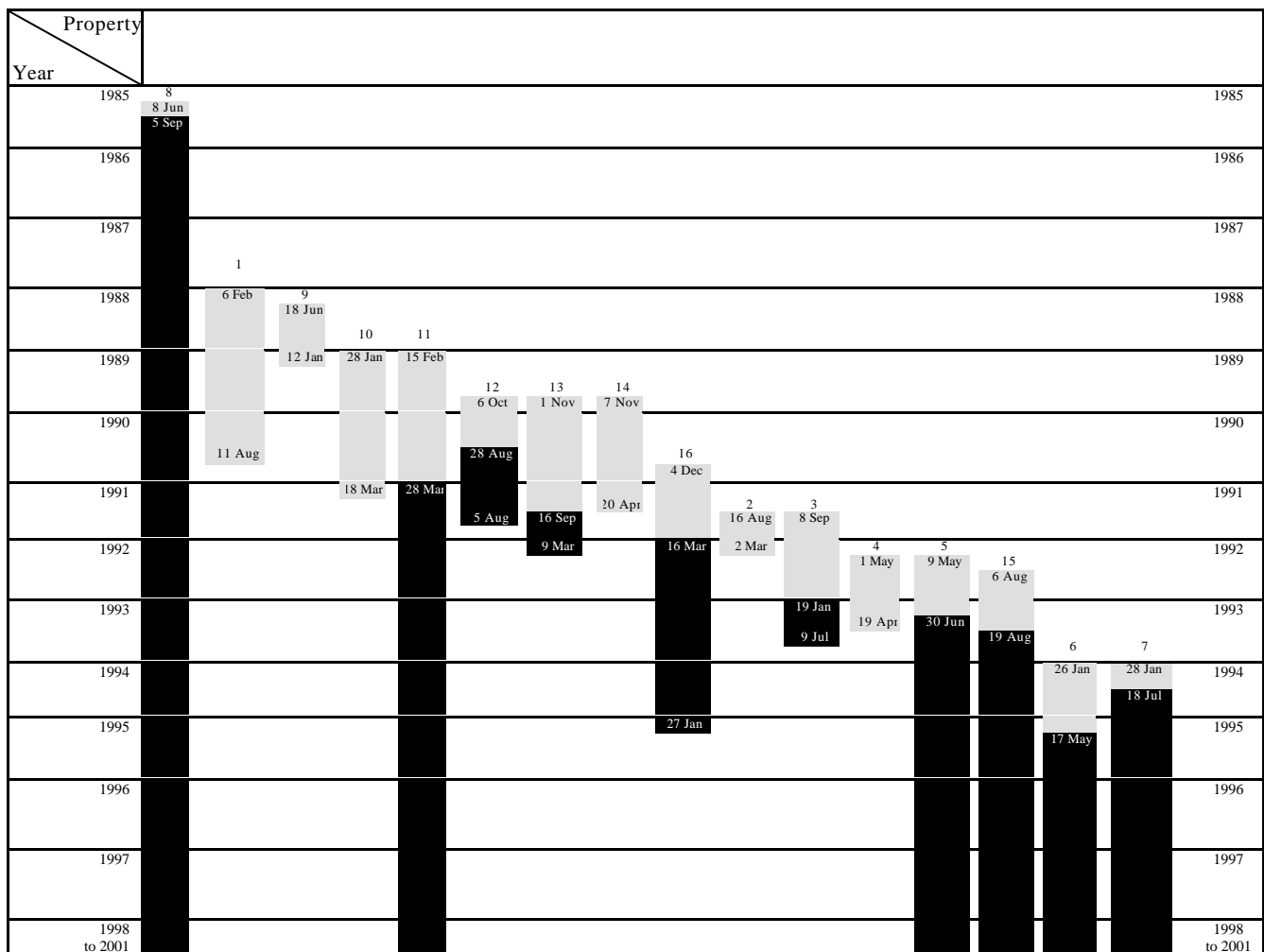
Note: Date in bracket refers to date of provisional agreement

Chart II

**Appeal to the Board of Review
by Mr A and Madam C (' the Taxpayers ')
against profits tax assessments - 1990/91, 1991/92 and 1993/94**


Exhibit submitted by the Commissioner's representative

Exhibit 3: Chart of properties owned by the Taxpayers by time sequence



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 Period before assignment of property to Mr A/Madam C/the Taxpayers

 Period after assignment of property to Mr A/Madam C/the Taxpayers

Reference: Exhibit 1

(Note: This chart is not drawn to scale)