

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D79/94

Profits tax – purchase and sale of property – whether capital gain or profit on trading transaction.

Panel: Andrew J Halkyard (chairman), Sydney Leong Siu Wing and Andrew Wang Wei Hung.

Date of hearing: 1 March 1995.

Date of decision: 31 March 1995.

The taxpayer purchased a flat under construction on 11 April 1990. The building was completed on 8 April 1991 and the flat was assigned to the taxpayer on 4 July 1991. On 11 August 1991 the taxpayer sold the property at a substantial profit with completion of the sale taking place on 15 October 1991. The assessor was of the opinion that the profit was assessable to profits tax. The taxpayer objected on the ground that the property had not been purchased for the purpose of resale.

Held:

The taxpayer did not appear and give evidence before the Board. On the evidence before it the Board was not satisfied that the taxpayer had any intention other than the purchase of the property with a view to its resale. However the Board accepted that the profit made by the taxpayer was less than that assessed. Accordingly the appeal was allowed to the extent that the assessment should be reduced to the amount of the actual profit made.

Appeal partly allowed.

Cases referred to:

Simmons v CIR [1980] 53 TC 461

Marson v Morton [1986] 1 WLR 1343

All Best Wishes Ltd v CIR [1992] 3 HKTC 750

Tam Tai Pang for the Commissioner of Inland Revenue.

Taxpayer represented by her accountant.

Decision:

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The Taxpayer has appealed against a determination of the Commissioner of Inland Revenue which confirmed the 1991/92 profits tax assessment raised on her. The Taxpayer claims that the profit she derived from disposal of a property is capital in nature and that, in any event, the amount of the estimated assessable profits is excessive.

Mr A ('the representative') appeared for the Taxpayer. The Taxpayer did not appear to give evidence before the Board. The following facts are not, however, in dispute.

The facts

1. On 11 April 1990, the Taxpayer entered into a provisional sale and purchase agreement to purchase a property known as Flat X, ('the Property') for a consideration of \$2,573,100.
2. At the time of the Taxpayer's purchase, the Property was under construction. The occupation permit was issued on 8 April 1991.
3. By a deed dated 4 July 1991, the Property was formally assigned to the Taxpayer.
4. On 11 August 1991, the Taxpayer entered into a provisional sale and purchase agreement to sell the Property for a consideration of \$3,480,000. The sale was completed on 15 October 1991.
5. In response to the assessor's enquiry, the Taxpayer gave, in a letter dated 15 July 1993, certain particulars regarding the acquisition and disposal of the Property. In that letter it was disclosed that the purchase price for the Property was, in part, financed by way of a ten year mortgage from Bank Y amounting to \$1,500,000.
6. The Taxpayer submitted a profits tax return for the year of assessment 1991/92 declaring that she did not carry on any trade or business.
7. The assessor was of the view that the Taxpayer's acquisition and resale of the Property amounted to an adventure in the nature of trade and that therefore the profits derived from its disposal should be charged to profits tax. On 3 February 1994, the assessor raised on the Taxpayer a profits tax assessment for the year of assessment 1991/92 showing estimated assessable profits of \$821,900 with tax payable thereon of \$123,285. In estimating the assessable profits, the assessor made an allowance for expenses which might have been incurred by the Taxpayer in the acquisition and disposal of the Property.
8. On 24 February 1994, the Taxpayer objected against the 1991/92 profits tax assessment on the grounds that the profit derived from the Property was capital in nature and not taxable, and that the amount of the estimated assessable profits was excessive.
9. On 24 September 1994, the Commissioner of Inland Revenue issued a determination rejecting the Taxpayer's objections and confirming the 1991/92 profits tax assessment.

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10. On 18 October 1994, the Taxpayer appealed against the Commissioner's determination to the Board of Review. The Taxpayer contends that the Property was not purchased for the purpose of resale at a profit and that, in any event, the assessed profits are excessive.

11. Prior to the Board hearing, the Taxpayer supplied various legal documents relating to the purchase and sale of the Property. The Taxpayer also supplied other documents showing her expenditure in purchasing, holding and disposing of the Property. Amongst these documents was a profit and loss account which stated that the net profit derived from disposal of the Property was \$498,665. In arriving at this net profit an amount of \$54,460 was deducted for basic decoration work. A copy of a document dated 4 June 1991 from Company Z ('the decorator') to the Taxpayer was supplied by the Taxpayer.

12. The Taxpayer has previously purchased and sold immovable property in Hong Kong on two occasions. These properties, located at Place E and Place F, were held for approximately 20 and 12 years respectively. The Taxpayer is presently a co-owner of a property located in Place G. This property was purchased in 1980.

The Taxpayer's contentions

In the Taxpayer's letter dated 15 July 1993 (fact 5 refers) the Taxpayer stated:

'The reason(s) for sale: I wanted to acquire the property for residence, and I moved in once the occupation permit was issued in June (sic) 1991. I lived in the premises for about a month. However, I found that there were few public transports served the area and burglaries happened in some of the units. So I changed my mind and decided to lease it out. I approached the nearby estate agents for assistance. To my disappointment, I waited for over 2 months and still could not find a suitable tenant. It might be due to the poor traffic condition in the area at that time and the people were unwilling to take up the newly built premises. Therefore I had no alternative but to sell it out in October.

The profit is capital in nature: I believe that the profit obtained from realisation of my property should not be taxable. It is because the property is acquired for residence and letting purposes. I have no intention of buying a property for speculation. If that be the case, I shall dispose it before the issue of the occupation permit so as to avoid the stamp duty and relevant legal expenses...'

During the Board hearing, the representative reiterated these contentions. In addition, the representative argued that the Taxpayer's history of property transactions (fact 12 refers) did not disclose any pattern of property dealing. Indeed, according to the representative, it was quite the reverse.

The representative also raised various other matters which were essentially an attempt to adduce evidence. At best, they were hearsay; but such hearsay was not introduced by the representative as sworn evidence which could be subjected to cross-examination by the Commissioner's representative. The Board has placed no weight

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on these unsworn statements. Even if the Board were disposed to accept them, it would have concluded that they would not assist the Taxpayer's case. To provide but one example, the representative stated that the Taxpayer only stayed in the Property for 'one or two nights' and that the Taxpayer felt 'uncomfortable about the Property as soon as she opened the window'. That may well be the case. But the fact remains that, from the perspective of the Board, these statements are pure conjecture. If accepted, they introduce matters which were never previously advanced by the Taxpayer. Their submission, at this late stage of the dispute, could only cast doubt upon the Taxpayer's written statement in which a one month period of residence was referred to and different reasons were put forward for abandoning the claimed intention of residing in the Property.

The Commissioner's contentions

The representative for the Commissioner contended that the Taxpayer's submissions as to her intention for purchasing the Property as a residence were simply not supported by evidence. Moreover, the Commissioner argues that disposal of the Property within five weeks of the formal assignment shows that the Taxpayer had no firm, if any, intention of using the Property as claimed; rather, the objective facts point strongly to a trading intention. In essence, the Commissioner submits that the Taxpayer has failed to discharge the onus of proving that, as an objective matter, she did not engage in an adventure in the nature of trade.

The Commissioner is, however, prepared to accept that the quantum of assessable profits should be adjusted in accordance with the Taxpayer's profit and loss account (fact 11 refers) with the exception that the claimed decoration expenses of \$54,460 should not be taken into account. The Commissioner contends that there is no evidence that this amount was paid to the decorator.

The course of the Board hearing

Apart from the documents referred to at fact 11, no additional evidence was submitted by the representative at the Board hearing. On the basis that direct oral testimony from the Taxpayer would be useful, if not crucial, to the Taxpayer's case the Board provided the representative with a choice: he could either apply for an adjournment in order to introduce oral testimony of the Taxpayer's intention in purchasing the Property or proceed to conclude this appeal on the basis of the facts and documents agreed by, and the submissions of, both parties. The representative indicated that he wished the appeal to proceed without adjournment. It was, in the representative's words 'inconvenient' for the Taxpayer to appear before the Board.

Analysis

The law relevant to this appeal is clear and is not in dispute. The question for decision is whether the Taxpayer is assessable to profits tax by having entered into an adventure in the nature of trade (sections 14 and 2(1), definition of 'trade'). To determine whether a property is a capital asset or a trading asset, the purchaser's intention at the time of acquisition is crucial. In Simmons v CIR [1980] 53 TC 461, Lord Wilberforce stated at page 491:

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'Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment?'

An intention to hold property as a capital investment must be definite and not simply a wish incapable of fulfilment. Moreover, the stated intention of a person is not decisive. Actual intention can only be determined objectively (usually on the basis of the so-called 'badges of trade', see Marson v Morton [1986] 1 WLR 1343 at pages 1348-1349).

In All Best Wishes Ltd v CIR [1992] 3 HKTC 750, Mortimer J stated at page 771:

'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.'

Finally, the onus of proving the assessment appealed against is excessive or incorrect is on the Taxpayer (section 68(4)).

Applying the law to the facts before us, we conclude that there is little evidence to support the claimed intention set out in the Taxpayer's letter of 15 July 1993 which was reiterated before the Board by the representative. The Board none the less appreciates the weight of the representative's submissions that the Taxpayer has no history of property dealing, that the Taxpayer financed a reasonable part of the purchase price of the Property from prior savings and that she did not sell before the issue of the occupation permit. These factors do not fit the classic mould of a property speculator. However, they do not necessarily preclude the conclusion that the Taxpayer's intention in purchasing the Property was for resale at a profit.

The Taxpayer alleged that she lived in the Property for one month, then instructed an agent to lease the Property, and then waited for two months before deciding to sell it. However, the period between the Taxpayer completing the purchase (fact 3 refers) and entering into an agreement to sell the Property (fact 4 refers) was slightly more than one month. If, as claimed by the Taxpayer, decoration work were undertaken, presumably it would be during this period. Given this time frame, it appears to the Board that it is not possible for the Taxpayer to have acted in the manner set out in her letter of 15 July 1993. This and other matters which troubled the Board, such as a total absence of independent evidence supporting the Taxpayer's contentions that she resided in the Property, could have been dispelled by oral testimony of the Taxpayer and by readily obtainable documentary evidence, such as correspondence with the electric and water authorities to show the use of utilities during the claimed period of use. No such testimony or evidence was forthcoming. In the result, on the basis of the facts and documents before it, the Board is unable to conclude that the Taxpayer's contentions as to her reasons for purchasing the Property have been substantiated.

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In these circumstances, the Taxpayer could only succeed on the first ground of appeal by showing demonstrably that the Commissioner was wrong in reaching the conclusion that she had embarked upon an adventure in the nature of trade. In view of the short holding period, the absence of proof of the Taxpayer's intention at the time of purchasing the Property and the evidential factors referred to above which, while remaining unexplained, must cast doubt upon the Taxpayer's claims, it was clearly open to the Commissioner to decide that in purchasing and selling the Property the Taxpayer had engaged in an adventure in the nature of trade. We therefore conclude, in relation to the first ground of appeal, that the Taxpayer has not discharged the onus of proving that the basis of the assessment was incorrect.

The Board is, however, prepared to allow the second ground of appeal and reduce the 1991/92 profits tax assessment to assessable profits of \$553,125. In this regard, the Board agrees with the Commissioner's representative that no deduction should be allowed for the claimed decoration expenses of \$54,460 (fact 11 refers). The document referred to at fact 11 provides a breakdown of certain types of decorative work together with dollar amounts which total \$54,460. The document does not state that any decorative work had been carried out; and there is no indication on the face of the document that it represents an invoice for decoration work undertaken or that it is a receipt for payment. In short, there is no evidence before the Board that this amount was incurred by the Taxpayer.

In the event, this appeal is allowed to the extent indicated in the previous paragraph. The 1991/92 profits tax assessment is reduced to \$553,125.