

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D79/99

Profits Tax – sale of property – whether for long term investment or used as a trading asset – sections 2, 14(1) and 68(4) of the Inland Revenue Ordinance, Chapter 112.

Panel: Anna Chow Suk Han (chairman), Peter R Griffiths and Roderick Woo Bun.

Date of hearing: 21 July 1999.

Date of decision: 22 October 1999.

The taxpayers entered into an agreement to purchase the Subject Property on 16 May 1996 and completed the purchase on 6 August 1996. On 28 January 1997, they entered into an agreement to sell the Subject Property. Completion took place on 19 March 1997. The Subject Property was sold at a profit. The assessor was of the view that the assessable profits is \$853,128. The taxpayers appealed against the said determination on the grounds (1) the Subject Property was purchased as a residence. It was sold because the taxpayer wished to change for a bigger residence to improve their living conditions and (2) the profits of the Subject Property has been ploughed back to a new property where the taxpayers have just moved in, so there is no actual profits from the Subject Property.

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 (Simmons v IRC [1980] 1 WLR 196 applied).
2. A self-serving statement by a person is of limited value until it has been tested against the objective facts (All Best Wishes Limited v CIR 3 HKTC 750 applied).
3. Unless it is satisfactorily explained away, a quick sale of a property is normally regarded as being inconsistent with an intention of holding an asset as a long-term investment and being consistent with an intention of holding it for sale at a profit.
4. On the evidence the Board cannot accept that the taxpayers' expressed intention was a genuine one for the following reasons:

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- (1) The taxpayers alleged that they sold the Subject Property because they needed a bigger flat for their baby. However, when they acquired the Subject Property they already had their baby;
 - (2) The taxpayers' allegation that the Subject Property was sold because they were offered a good price for it was also consistent with the intention that it was acquired as a trading stock to be disposed of at a profit;
 - (3) The taxpayers' never relinquished their original property as their residence was also inconsistent with the claim that the Subject Property was intended as the taxpayers' residence;
 - (4) The electricity consumption of the original property and the Subject Property were also indicative of the fact that the Subject Property was not intended to be used as the taxpayers' residence;
 - (5) Despite the taxpayers' claim that they intended to sell both the original property and the Subject Property, and combining the proceeds of sale therefrom, they would acquire a bigger flat as their residence, after selling the Subject Property, they were still retaining the original property;
 - (6) The very fact that the taxpayers had in mind to acquire a bigger flat as their residence when the Subject Property was purchased, is self-evident that the Subject Property was not intended to be their residence.
5. Since the taxpayers have failed to discharge their onus of proving that the Subject Property was acquired as their residence, the claim that the profit from it was ploughed back to the new property was of no consequence.

Appeal dismissed.

Cases referred to:

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Simmons v IRC (1980) 1 WLR 196
All Best Wishes Limited v CIR 3 HKTC 750

Chu Wong Lai Fun for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The appeal

1. Mr A and Ms B (hereinafter referred to as ‘ Mr A ’ and ‘ Ms B ’ individually and as ‘ the Taxpayer ’ collectively) have objected to the profits tax assessment for the year of assessment 1996/97 raised on them. The Taxpayer claims that the profit derived from the sale of a property at District C (‘ Property 2 ’) should not be assessable to tax because Property 2 was acquired by them as their residence.

2. This is the appeal by the Taxpayer against the determination dated 23 March 1999 by the Commissioner of Inland Revenue(CIR), rejecting their objection to the aforesaid profits tax assessment.

The background

3. The Taxpayer are husband and wife. They have jointly purchased and sold the following properties since 1 April 1994:

	Date of purchase	Purchase price \$	Date of sale	Selling price \$
(a) Property 1	3-6-1994 (1-10-1994)	3,730,000		
(b) Property 2	16-5-1996* (6-8-1996)	3,380,000	28-1-1997* (19-3-1997)	4,538,000
(c) Property 3	17-3-1997 (30-4-1997)	3,200,000		
(d) Property 4	22-11-1997* (23-2-1998)	6,980,000		

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Notes: * refers to the date of the provisional agreement.
The date in brackets refers to the date of assignment.

4. To finance the purchase of Property 2, the Taxpayer borrowed on 6 August 1996 a staff housing loan of \$3,042,000 from Mr A's employer, Bank D. The principal and interests of the loan were repayable by 300 monthly instalments of \$17,680.42 each.

5. The assessor was of the view that the purchase and resale of Property 2 by the Taxpayer amounted to an adventure in the nature of trade. In the absence of a completed profits tax return, the assessor raised on the Taxpayer the following profits tax assessment for the year of assessment 1996/97:

Estimated assessable profits	<u>\$850,000</u>
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6. (a) The Taxpayer objected against the above assessment on the following grounds:

‘ The profits of (Property 2) has been ploughed back to the new property (Property 4) where I have just moved in, so there is no actual profits from the old property.’

(b) By a letter dated 1 October 1998, the Taxpayer contended that Property 2 was purchased as a residence. It was sold because the Taxpayer wished to change for a bigger residence to improve their living conditions.

7. (a) To explain the long time gap between the sale of Property 2 and the purchase of Property 4, the Taxpayer stated that:

‘ I intend to buy another flat during I sold out my flat in District C, however, due to my company's housing loan policy, I m not eligible to change property within two years after my loan had drawn down. The other condition that I was able to change of my property was I being promoted ... My immediate superior informed me that my promotion had been approved on November and the effective date was 1 January 1998. ... Upon my boss notification, I started to look for a better flat and finally purchased an older but bigger flat at District E.’

(b) The Taxpayer also submitted a letter showing the terms and conditions of the staff housing loan operated by Bank D. The letter contains, among others, the following conditions regarding the change of properties:

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‘ Staff members may apply for second or subsequent loan when (i) they have occupied the old property for two years or (ii) they are promoted to a higher grade, subject to a life time maximum of borrowing five times.’

8. In response to the assessor’s enquiries, the Taxpayer provided the following information about Properties 1, 2, 3 and 4:

Residential address	Usable area (in square feet)	Number of bedroom	Period of occupation by the Taxpayer & their family
Property 1	434	2	4-1995 to 7-1996
Property 2	600	2	8-1996 to 3-1997
Property 3	434	2	4-1997 to 1-1998
Property 4	970	3	2-1998 to 11-1998

Property 1 was vacant during the period from February 1998 to July 1998 and was then let out. Property 3 was vacant during the period from May 1997 to August 1997 and was then let out.

9. The electricity consumption records of Property 1 which showed that there was substantial electricity consumption during the period from August 1996 to March 1997, are as follows:

Reading date	Units consumed	Billing amount
		\$
21-3-1997	311	247.42
24-2-1997	344	275.95
24-1-1997	376	302.94
20-12-1996	306	241.10
22-11-1996	378	301.00
24-10-1996	491	395.02
23-9-1996	552	445.76
22-8-1996	519	418.30

While the electricity consumption records of Property 2 are as follows:

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Reading date	Units consumed	Billing amount \$
18-3-1997	5	3.90
5-3-1997	27	21.06
4-2-1997	422	343.43
6-1-1997	453	366.10
4-12-1996	475	381.70
5-11-1996	259	203.30
3-10-1996	7	7.74
4-9-1996	130	100.62
12-8-1996	0	

10. The profits tax assessment for the year of assessment 1996/97 was revised by the assessor as follows:

	\$	\$
Selling price		4,538,000
<u>Less: Purchase price</u>	3,380,000	
Legal fee on purchase	25,100	
Stamp duty	67,600	
Agency fee on purchase	33,800	
Decoration	26,800	
Bank interest	87,745	
Life insurance	3,247	
Valuation fee	350	
Legal fee on sale	14,850	
Agency fee on sale	<u>45,380</u>	<u>3,684,872</u>
Revised assessable profits		<u><u>853,128</u></u>

The relevant statutory provisions

11. Section 14(1)

‘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.’

12. Section 2

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“trade” includes every trade and manufacture, and every adventure and concern in the nature of trade.’

13. Section 68(4)

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

The established legal principles

14. 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 the case of Simmons v IRC [1980] 1 WLR 196, Lord Wilberforce said at page 1199 :

‘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 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?’

15. A self-serving statement by a person is of limited value until it has been tested against the objective facts. 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. 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.’

The Taxpayer’s evidence

16. Mr A gave evidence on behalf of himself and Ms B. Mr A was working for Bank D. When Property 2 was purchased, the Taxpayer was living at Property 1. Mr A asserted that Property 2 was acquired as the Taxpayer’s residence and this intention was supported by the fact that the purchase was financed by a staff housing loan from Bank D, which would not be available,

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had Property 2 not been for self use. Property 2 was sold because they needed a bigger place for their baby, they had a good offer for Property 2 and they could also move back to Property 1. The profits from the sale of Property 2 was ploughed back to Property 4.

17. In cross-examination, Mrs Chu for the Respondent (the CIR) queried the Taxpayer's expressed intention on the location factor. Both Property 1 and Property 4, being the Taxpayer's residence, were in District F while Property 2 was in District C. Mr A explained that Bank D was then moving its office to District C, which would be close to Property 2. Mr A further explained that he did not look for another property after the sale of Property 2, till much later due to the bank's staff housing loan policy. He was not eligible for another loan within two years after the drawdown of his first loan, unless he had a promotion. He was informed of his promotion in November 1997 and the effective date was 1 January 1998. Upon notification of his promotion, he started looking for a better flat and finally found Property 4 which was an older but bigger flat. Mr A claimed that he had always been looking for a better flat even before his being notified of his promotion but he was deterred by the fact that he would need to apply for a mortgage with customer interest rate.

18. Mrs Chu contended that even though a staff housing loan was obtained by the Taxpayer, the bank did not check nor was it in a position to check how Property 2 was being used. Mr A claimed that the actual use was verified by the bank by means of sending correspondence to that address and also by relying on Mr A's declaration to the effect that it was being so used and that failure to observe the condition for self-use would result in termination of his contract by the bank.

19. Mr A was also challenged on the fact that when he acquired Property 2, the Taxpayer already had their baby. Mr A claimed that after their baby was born, it was being looked after by and was living with Ms B's aunt. He claimed that they could not have the baby living with them at the time because both Property 1 and Property 2 had only two rooms. As they wished to have the baby back to live with them, they required a bigger flat, and Property 4 had three rooms.

20. Mr A informed the Board that Property 1 was not let out during the period from 1 April 1996 to 31 March 1997.

21. Mr A claimed that since it was close to his office, he even moved into Property 2, while it was under decoration. All the personal belongings were not moved to Property 2 because there was no urgency to do so, since Property 1 was neither sold nor let out and Ms B was still working in District G.

22. Mrs Chu contended that Property 2 had never been used by the Taxpayer as their residence as they never informed Inland Revenue Department of their change of address. They also put in the provisional agreement for the sale of Property 2, the address of Property 1 as their

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home address. Mr A explained that it did so happen, because they were occupying both Property 1 and Property 2 at the same time.

23. Mrs Chu also referred Mr A to the considerable electricity consumption at Property 1 during the period between August 1996 and March 1997 and the low electricity consumption at Property 2 in September 1996, February and March 1997.

24. Mr A contended that even at the time when Property 2 was purchased, they were looking for a bigger flat. If they did not have other options, Property 2 would have been held for a long term. Since later on they had other options and he had a promotion, by selling Property 1 and Property 2 and combining their proceeds of sale, they could buy a bigger flat.

25. Mr A informed the Board that after the sale of Property 2, he intended either to sell or to let out Property 1. But letting out would be the last resort. However, he had difficulty in selling Property 1 as it was purchased at a high price and he did not wish to make a loss.

26. He also informed the Board that Property 3 was purchased by him jointly with a friend for investment purpose. A mortgage loan equal to 70% of the purchase price was obtained from a bank and he put down about one-third of the balance, that is, about \$370,000 towards the purchase price.

27. Mr A was questioned by the Board as to whether it was his intention to sell Property 2 to get a profit first when he saw the market was good and then he waited for an appropriate moment to get a new residence. His answer to this question was in the affirmative.

28. Mr A informed the Board that Property 2 was sold on the first offer made to them when an estate agent brought a cheque to his office before Property 2 was viewed by the intended purchaser.

The Respondent's (the CIR's) submission

29. It was submitted by Mrs Chu that it was clear from the Taxpayer's own admission and the objective facts that at the time of acquisition of Property 2, the Taxpayer did not take into account whether the size and the surrounding environment of Property 2 were suitable to their needs and that they had in mind selling Property 2 even at the time when it was purchased.

30. The Board's attention was drawn to the following:

- (a) Property 1 was located at District F which has a better environment than Property 2.

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- (b) The usable area of Property 2 (600 square feet) was not much bigger than that of Property 1 (434 square feet). Both had only two bedrooms.
- (c) The Taxpayer did not sell nor let out Property 1 after acquiring Property 2.
- (d) The electricity consumption records of Property 1 and the fact that the address of Property 1 was put as their home address on the provisional agreement for sale of Property 2, suggested that the Taxpayer continued residing at Property 1 while they was holding Property 2.
- (e) The Taxpayer sold Property 2 immediately when they saw they could make a profit from it. The readiness to sell and the short period of ownership were indicative of trading.
- (f) The Taxpayer was prepared to sell notwithstanding Mr A would not be eligible for a second housing loan until eighteen months after the sale of Property 2 or until he had a promotion.
- (g) The Taxpayer did not look for a larger residence until November 1997, being ten months after they contracted to sell Property 2.
- (h) The Taxpayer continued living at Property 1 until they purchased Property 4 which was a larger flat and also located at District F.

31. The Taxpayer had no intention to hold Property 2 for a long term but were waiting for an opportune moment to sell it at a profit which could be used to purchase a bigger flat. It is clear that Property 2 was purchased with the intention of it being disposed at a profit – the very essence of trading.

32. The Taxpayer's contention that they lived at Property 2 for a short period and that the profit derived from the sale was ploughed back to Property 4 was not inconsistent with their intention of acquiring Property 2 for disposal of it at a profit.

33. Minor decoration to Property 2 and continuing living at Property 1, cast serious doubt on the Taxpayer's claim that Property 2 was acquired as a long-term investment.

Our findings

34. Unless it is satisfactorily explained away, a quick sale of a property is normally regarded as being inconsistent with an intention of holding an asset as a long-term investment, and being consistent with an intention of holding it for sale at a profit.

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35. In the present case, the Taxpayer entered into an agreement to purchase Property 2 on 16 May 1996 and completed the purchase on 6 August 1996. On 28 January 1997, they entered into an agreement to sell Property 2. Completion took place on 19 March 1997. Property 2 was sold at a profit. Despite their stated intention that Property 2 was acquired for use as their residence, the Taxpayer sold it because they received a good offer and because they needed a bigger flat for their baby. Their stated intention is not decisive and has to be tested against the surrounding circumstances and the objective facts.

36. On the evidence before us, we cannot accept that the Taxpayer's expressed intention was a genuine one.

37. The Taxpayer sold Property 2 because they needed a bigger flat for their baby. As it was, when they acquired Property 2, they already had their baby. Had they found Property 2 not suitable as a residence for the whole family, they should not have bought it in the first place. It follows that Property 2 could not be intended as their residence when it was acquired.

38. Furthermore, the Taxpayer asserted that Property 2 was sold because they were offered a good price for it. This reason for selling was also consistent with the intention that it was acquired as a trading stock to be disposed of at a profit. The Taxpayer decided to sell on the first offer they received. Not much persuasion was needed to convince them to sell. Such quick and easy decision to sell would be inconsistent with the expressed intention that it was acquired as a residence.

39. The fact that the Taxpayer never relinquished Property 1 as their residence was also inconsistent with the claim that Property 2 was intended as the Taxpayer's residence.

40. The electricity consumption records of Property 1 and Property 2 are indicative of the fact that Property 1 was used as their residence rather than Property 2.

41. Furthermore, despite the Taxpayer's claim that they intended to sell both Property 1 and Property 2, and combining the proceeds of sale therefrom, they would acquire a bigger flat as their residence. After selling Property 2 and acquiring Property 4, they are still retaining Property 1.

42. The fact that Mr A obtained a staff housing loan from his employer, Bank D, is not conclusive of the fact that Property 2 must have been used by the Taxpayer as their residence. Mr A's declaration was a self-serving document which is required to be tested against other evidence available.

43. The very fact that the Taxpayer had in mind to acquire a bigger flat as their residence when Property 2 was purchased, is self-evident that Property 2 was not intended to be their residence.

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44. In our view, there is overwhelming evidence that the Taxpayer did not acquire Property 2 with the intention of holding it as their residence but they acquired it and sold it in pursuit of an adventure in the nature of trade. The profit arising therefrom is assessable to profits tax.

45. As to the Taxpayer's contention that the profit from the sale of Property 2 was ploughed back to Property 4, it has not escaped our mind what was said in Simmons' case:

'As permanent investment may be sold in order to acquire another investment thought to be more satisfactory, that does not involve an operation in trade whether the first investment is sold at profit or at a loss.'

However, since the Taxpayer has failed to discharge their onus of proving that Property 2 was acquired as their residence, the claim that the profit from it was ploughed back to Property 4 was of no consequence in this appeal.

46. Accordingly, we dismiss the appeal and hereby confirm the assessment.