

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D84/00

Profits tax – real property – whether the gains arising from the disposal of a property was liable for profits tax.

Panel: Ronny Wong Fook Hum SC (chairman), Benjamin Chain and Ho Kai Cheong.

Date of hearing: 4 July 2000.

Date of decision: 7 November 2000.

The taxpayer was a private company incorporated in Hong Kong. According to the report of its directors for the year ended 31 March 1994 ‘the principal activities of the company were engaged in providing consultancy services and sub-letting property during the year’.

On 1 December 1990 the taxpayer purchased Property 2 for \$1,363,000. This purchase was pursuant to a resolution of the taxpayer of the same date. The resolution was silent as to the rationale behind this acquisition. Temporary occupation permit in respect of Property 2 was issued on 20 October 1992. By a provisional agreement dated 11 November 1993, the taxpayer sold Property 2 for \$3,350,000. Subsequently the taxpayer had dealings in other properties.

The taxpayer contended, inter alia, that

1. Attempts were made to let out Property 2.
2. The taxpayer had been cautious in selecting its tenant.
3. Although it was originally planned for long term investment, it was gradually found that was not as successful as expected because the property had never been let. So it was decided to sell Property 2 and with the proceeds thereof re-acquire other properties of higher quality and potential.
4. The proceeds of sale were all used back in other items of investment and not distributed by way of dividend or bonus to the shareholders straightaway.

A director of the taxpayer gave evidence at the hearing.

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Held:

1. The taxpayer relied on its dealings with other properties as supportive of its intention in relation to Property 2. The Board was of the view that this factor of subsequent dealings of the taxpayer was only neutral in the weighing exercise.
2. The evidence indicated that Property 2 was highly unlikely to excite the interest of a respectable tenant. The Board did not believe the director's testimony and was not satisfied that the taxpayer had a genuine intention to purchase Property 2 as a long term investment. On the evidence of the director, such alleged intention was unrealistic and not realisable.

Appeal dismissed.

Case referred to:

All Best Wishes Limited v CIR 3 HKTC 750

Chan Tak Hong for the Commissioner of Inland Revenue.

Taxpayer represented by its director.

Background

1. The Taxpayer is a private company incorporated in Hong Kong on 9 September 1988. At all material times, its issued share capital was two shares of \$1 each and its directors were Mr and Mrs A. According to the report of its directors for the year ended 31 March 1994, 'The principal activities of the company were engaged in providing consultancy services and sub-letting property during the year.'
2. Mrs A was a partner of a real estate agency in the name of Company B which commenced business on 15 September 1985 and ceased business on 31 August 1987.
3. On 15 May 1986, Mrs A purchased Property 1 for \$360,000.
4. On 1 December 1990, the Taxpayer purchased Property 2 for \$1,363,000. This purchase was pursuant to a resolution of the Taxpayer of the same date. The resolution is silent as to the rationale behind this acquisition. Temporary occupation permit in respect of Property 2 was issued on 20 October 1992. By a provisional agreement dated 11 November 1993, the Taxpayer sold Property 2 for \$3,350,000.

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5. By an agreement dated 22 January 1994, the Taxpayer purchased Property 3 in Housing Estate C for \$2,705,600. On 29 March 1994, the Taxpayer purchased a further flat in Housing Estate C [Property 4] for \$2,886,000.
6. By an agreement dated 26 April 1994, the Taxpayer purchased Property 5 for \$4,381,000. By an agreement of the same day, Mrs A purchased Property 6 in the same complex for \$4,035,000. The Taxpayer sold the Property 5 by an agreement of 30 September 1994 for \$4,505,000. That sale was made shortly before issuance of the occupation permit in respect of the same on 19 October 1994.
7. By an agreement dated 28 March 1995, the Taxpayer sold Property 3 for \$3,450,000.
8. By an agreement dated 15 October 1996, Mrs A sold Property 1 for \$1,745,000.
9. The issue before us is whether the Taxpayer is assessable for profits tax in respect of gains it derived through its dealings with Property 2.

Case of the Taxpayer

10. In relation to Property 2
 - (a) The gross floor area of the flat was 820 square feet consisting of one sitting room and three bedrooms.
 - (b) The Taxpayer ' was given priority to select a flat from the development through the introduction of a friend who was acquainted with the developer' s staff.'
 - (c) This flat was purchased with loans of \$800,000 and \$194,500 extended by Mr A and Mrs A.
 - (d) Attempts were made to let out this flat. There is no document in support of such attempts as contacts with estate agents were made by phone and no advertisement was placed in the newspapers due to the costs involved.
 - (e) The Taxpayer had been cautious in selecting its tenant. Emphasis was placed on the occupation of the tenant; the business of his employer and whether the tenant is an expatriate working in Hong Kong.
 - (f) ' Although it was originally planned for long term investment, it was gradually found that was not as successful as expected because the property had never

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been let. This may be attributable to a number of factors including the location and environment of the surroundings. A Bus Terminal for Cross Harbour Tunnel Bus is situated to the front of the building, a street market full of hawking stalls is at the other side of the rear and an unloading area for barges parked alongside a housing estate, not far away from the building. And coincidentally, the property market ... was booming at the material time, pushing the purchase price to a record-high level. So, it was decided to sell the said property and with the proceeds thereof and re-acquire other properties of higher quality and potential.'

- (g) The proceeds of sale 'were all used back in other items of investment' and not distributed by way of 'dividend or bonus to the shareholders straightaway'.
- (h) The Taxpayer further contended that we should not place any weight on a letter dated 25 January 2000 from the property agency Company D to the Revenue wherein Company D pointed out that they 'have no information showing that [the Taxpayer] had ever listed the above property for both sale or/and rent of the above property through our company.'

11. In relation to Property 3

- (a) The flat had a saleable area of 55.56 square metre with one sitting room and two bedrooms.
- (b) It was allegedly purchased as the 'vacation resort' for the Taxpayer's personnel.
- (c) It was sold because upon completion of the development, it was discovered that the view of part of this flat was obstructed by the house in front and 'As advised by the Fung Shui master, that could cause health problem to the occupants and bring bad luck to the [Taxpayer].'

12. Property 4

- (a) The flat had a saleable area of 62.08 square metres with one sitting room and two bedrooms.
- (b) This flat was purchased with the aid of a mortgage loan of \$2,000,000 repayable by 216 monthly instalments.
- (c) It was rented out as from 1 February 1996.

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13. Property 5

- (a) The flat had a saleable area of 614 square feet with one sitting room and three bedrooms.
- (b) This flat was purchased for investment purpose. It was brought in the belief that the MTR route would be extended to the district where it is located. That expectation did not materialise. 'The traffic condition there at peak hours was extremely congested and without the benefit of MTR service, the value of this investment can hardly be expected to rise.'

The oral testimony of the Taxpayer before us

14. Mrs A gave evidence before us. Her evidence may be summarised as follows:

- (a) She admitted that she was a partner of Company B. Her friend Miss E was then unemployed. She decided to work part-time in this partnership business. The partnership was dissolved as Miss E managed to locate full time employment and she was unfamiliar with the real estate business. The business of Company B was not a successful one. Company B failed to close any deal.
- (b) The minutes of the Taxpayer dated 1 December 1990 was prepared by its solicitors. It is in standard form.
- (c) Property 2 was introduced to her by a friend. The unit was recommended to her as being well located and suitable for long term investment.
- (d) Property 2 was offered for letting via various real estate agencies shortly after the Taxpayer obtained possession of that premises. She gave oral instructions to those agencies in the name of Miss F, her maiden name. She was very particular about her tenant. She insisted in having three months deposit and three months advance payment of rates so as to prevent loss to the Taxpayer.
- (e) She reduced her asking rental when she failed to secure a suitable tenant. Her efforts did not yield any fruit.
- (f) After putting Property 2 in the market for rental for a spell, an estate agent told her that the unit had risen in price. In view of her failure to secure a tenant, she therefore decided to dispose of it and reinvest in other properties.
- (g) She maintained that Property 3, Property 4 and Property 5 were all purchased for investment purposes.

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The applicable principles

15. The principles are clear. We have to ascertain the intention of the Taxpayer at the time when Property 2 was purchased. We have to be satisfied that the Taxpayer's intention was to purchase the same as a long term investment and such intention is on the evidence 'genuinely held, realistic and realisable'.

16. As pointed out by Mortimer J (as he then was) in All Best Wishes Limited v CIR 3 HKTC 750:

' 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'

Our decision

17. We place no weight on the relationship between Mrs A and Company B. That estate agency business took place in 1985 to 1986. It was not the business of the Taxpayer. We also place no weight on the correspondence between the Revenue and Company D at the beginning of this year. The terms of Company D's reply of 25 January 2000 is ambiguous and the Taxpayer rightly contends that it is entitled to test the accuracy of such evidence.

18. The Taxpayer relies on its dealings with Property 3, Property 4 and Property 5 as supportive of its intention in relation to Property 2. Property 4 was rented out. Property 3 and Property 5 were only kept for a short spell without producing any income. We are of the view that this factor of subsequent dealings of the Taxpayer is only neutral in our weighing exercise. We do not propose to discuss this factor further so as not to prejudice the fiscal status of these units in subsequent proceedings.

19. Property 2 was purchased on 1 December 1990. Temporary occupation permit in respect of this unit was issued on 20 December 1992. It was sold on 11 November 1993, slightly over a year after the issuance of the occupation permit.

20. We ask ourselves this question : has the Taxpayer demonstrated a genuine intention to acquire Property 2 as a long term investment? The acquisition was quite fortuitous. The suitability of the unit as a long term investment was on the say so of a friend. We do not know how such recommendation could be reconciled with the actual vacancy of the flat between October 1992 (on the assumption but without proof that the Taxpayer obtained possession on that date) and November 1993. We are not impressed by Mrs A's evidence in relation to the steps she took in securing a suitable tenant. The availability of such tenant must depend on the location of the unit and

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its intrinsic appeal to prospective tenants. We considered her evidence in the light of the factors which the Taxpayer says had prompted its decision to sell Property 2. Those factors indicate that Property 2 is highly unlikely to excite the interest of a respectable tenant willing to pay three months deposits and three months advance of rates. We do not believe her testimony. We are not satisfied that the Taxpayer had a genuine intention to purchase Property 2 as a long term investment. On the evidence of Mrs A, such alleged intention is unrealistic and not realisable.

21. For these reasons, we dismiss the Taxpayer's appeal.