Case No. D91/01

Profits tax – property – whether investment or trade.

Panel: Kenneth Kwok Hing Wai SC (chairman), Christine Koo and Simon Lai Sau Cheong.

Date of hearing: 15 September 2001.
Date of decision: 19 October 2001.

The appellant bought a property which was still under construction in January 1996 and sold it in August 1997. She made net gain which was assessed to be profits.

She contended that the gain was capital in nature as the property was bought for her and her family.

Held:

The Board found no evidence supporting her contention.

Appeal dismissed.

Cases referred to:

Marson v Morton [1986] 1 WLR 1343
Simmons v IRC [1980] 1 WLR 1196
All Best Wishes Limited v CIR (1992) 3 HKTC 750

Lee Yun Hung for the Commissioner of Inland Revenue.
Taxpayer represented by her son.

Decision:

1. By his determination dated 31 May 2001, the Commissioner of Inland Revenue confirmed the profits tax assessment dated 23 May 2000 for the year of assessment 1997/98 under charge number 3-3821128-98-9, showing assessable profits of $1,144,180 with tax payable thereon of $154,464.

2. The Appellant's notice of appeal dated 30 June 2001 was received by the Clerk to the Board of Review on 3 July 2001, more than one month after the date of the determination.

3. We were told at the hearing by Mr Lee Yun-hung who represented the Respondent that the determination was posted to the Appellant and that the postal packet was delivered on 5 June 2001. This appeal was within the time prescribed by section 66(1) of the Inland Revenue Ordinance (Chapter 112) ('IRO') for appeal.

4. $1,144,180 was the amount of gain reported by the Appellant arising from the purchase and sale of a residential flat at District A ('the Subject Property'). The Appellant contended that the gain was capital in nature.

5. By a provisional agreement dated 20 January 1996, the Appellant agreed to acquire the Subject Property at $1,278,000. The Subject Property was then still under construction. The acquisition assignment is dated 19 July 1996. By a provisional agreement dated 25 August 1997, the Appellant agreed to sell the Subject Property at $2,580,000. The sale assignment is dated 27 November 1997. The expenses claimed by the Appellant in the document dated 15 June 1998 totalled $157,820, including $80,000 on decoration. The reported gain is thus $2,580,000 - $1,278,000 - $157,820 = $1,144,180.

6. The Subject Property has two bedrooms and its construction area is 581 square feet.

7. In 1978 the Appellant and his son acquired a residential flat at District B ('Property 1'). It has three bedrooms and its construction area is 703 square feet. By an agreement dated 26 February 1997, the Appellant and his son agreed to sell Property 1 at $2,780,000. The sale assignment is dated 15 May 1997.

8. The Appellant's case is that:

   (a) from about May 1997 to about March or April 1998 her son resided at a rented residential flat (with two bedrooms and a construction area of 538 square feet) ('Property 2') at the same estate as Property 1; and

(b) from about March or April 1998 her son resided at another rented residential flat (with three bedrooms and a construction area of 703 square feet) ('Property 3') also at the same estate as Property 1.

9. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Appellant. Section 2 defines 'trade' as including '*every trade and manufacture, and every adventure and concern in the nature of trade*'. Section 14(1) excludes profits arising from the sale of capital assets.

10. We remind ourselves of what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] 1 WLR 1343 at pages 1347 to 1349 and [1986] STC 463 at pages 470 to 471; what Lord Wilberforce authoritatively stated in Simmons v IRC [1980] 1 WLR 1196 at page 1199 and (1980) 53 Tax Cases 461 at pages 491 to 492; and the statement of the law by Orr LJ at pages 488 and 489 of the report in Tax Cases, which was approved by Lord Wilberforce as a generally correct statement (WLR at page 1202 and Tax Cases at page 495).

11. We remind ourselves also of what Mortimer J, as he then was, said in All Best Wishes Limited v CIR (1992) 3 HKTC 750 at page 770 and page 771.

12. The Appellant's case changed in the course of her written communications – see the document dated 15 June 1998, and her letters dated 17 June 2000, 17 July 2000, 4 September 2000, 13 November 2000, 18 May 2001, 30 June 2001 (notice of appeal) and 29 August 2001. By the time of the hearing of her appeal, her case was that the acquisition of the Subject Property was for long term investment:

(a) to solve the crowding problem at Property 1;

(b) because of disharmony with her daughter-in-law; and

(c) to grow old in.

13. She maintained her allegation that she had resided at the Subject Property from about January to December 1997. We have no hesitation in rejecting her allegation.

(a) If she had resided at the Subject Property for any material period, it is inherently improbable that **zero unit of electricity** had been consumed from 31 October 1996 to 21 June 1997, from 22 July 1997 to 20 August 1997, and from 22 September 1997 to 28 November 1997 when the account in the Appellant's name was closed. One unit of electricity means 1,000 watt-hour. Turning on one single two feet florescence tube (20 watt) for 50 hours consumes one unit of electricity. It is inherently improbable that the Appellant did not turn on any

electrical appliance which she might have at the Subject Property and turned off the refrigerator. Electricity was consumed only during two periods – 21 June 1997 to 22 July 1997 (five units) and 20 August 1997 to 22 September 1997 (one unit). The provisional agreement to sell is dated 25 August 1997 and the sale assignment is dated 27 November 1997.

(b) If she had resided at the Subject Property for any material period, it is inherently improbable that **zero unit of water** had been consumed from 19 December 1996 to 27 November 1997. We do not believe the Appellant would bath at her son's residence and do all her washings there on each and every day during the period of her alleged residence at the Subject Property.

(c) If she had resided at the Subject Property for any material period, it is inherently improbable that there was **no telephone** at the Subject Property, acquired in the sum of $1,278,000, with a further $80,000 on decoration. There is no allegation of any mobile phone.

14. We do not accept the allegation that the Subject Property was acquired to solve any alleged crowding problem at Property 1.

(a) If such were the intention, there is no reason for the Appellant not to have resided at the Subject Property after acquisition. For reasons we have given we have rejected her allegation of residence at the Subject Property.

(b) There is no reason why the son did not stay at Property 1, the alleged crowding problem having allegedly been solved by the Appellant moving out. On the contrary and on the Appellant's case, in about May 1997, the son moved to Property 2 which was smaller than Property 1, with one bedroom less.

(c) The Appellant and her son had ample time from the date of the provisional agreement to sell the Subject Property, that is, 25 August 1997, to prevent any alleged crowding by finding a larger unit to accommodate the Appellant, her son, her daughter-in-law and her two grandchildren. However, on the Appellant's case, the son stayed in Property 2 until about March or April 1998.

(d) Property 3 is no less 'crowded' than Property 1.

(e) On the Appellant's case, the alleged crowding had become worse and has never improved.

15. We do not accept the allegation that the Subject Property was acquired because of any alleged disharmony with her daughter-in-law.

(a) On the Appellant's case as stated in her letter dated 29 August 2001, her daughter-in-law resided elsewhere for nearly two years prior to August 1996. Thus at the date of the provisional agreement to acquire the Subject Property, 20 January 1996, the Appellant was not living with her daughter-in-law who had been living elsewhere for over a year. At the date of the acquisition assignment, 19 July 1996, the daughter-in-law was still living elsewhere.

(b) The day care centre receipts dated 22 May 1993 and 1 September 1993 in respect of the care of the granddaughter suggest that the daughter-in-law and the granddaughter had resided elsewhere for more than two years before August 1996.

(c) On the Appellant's case, the daughter-in-law returned in August 1996, a few months before the Appellant allegedly moved to the Subject Property in about January 1997.

(d) There is no allegation of any improvement in relationship between the Appellant and her daughter-in-law before the Appellant allegedly moved back to reside with her daughter-in-law. Yet on the Appellant's case, she has been residing with her daughter-in-law since about December 1997 – at Property 2 (about December 1997 to about March or April 1998) and at Property 3 since about March or April 1998.

16. We do not accept the allegation that the Subject Property was acquired for the Appellant to grow old in. If such were the case, it would have meant a lot to her and it would have taken a lot of persuasion or even compulsion before she would have agreed to dispose of it. In this case, there is no compelling reason for the Appellant to agree to the sale of the Subject Property. The Appellant signed the provisional agreement to sell the Subject Property within three months and ten days of having completed the sale of Property 1. Since December 1997, the Appellant has no flat of her own, whether in her sole or joint name, to grow old in.

17. The Appellant's son placed heavy reliance on the 'six badges of trade'. The 'badges of trade' [there are nine of them, not just six] must be understood in its context. Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] 1 WLR 1343 at pages 1347 to 1349 and [1986] STC 463 at pages 470 to 471 that:

> *' But as far as I can see there is only one point which as a matter of law is clear, namely that a single, one-off transaction can be an adventure in the nature of trade. Beyond that I found it impossible to find any single statement of law which is applicable to all cases in all circumstances.*
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> ...

> *It is clear that the question whether or not there has been an adventure in the nature of trade depends on all the facts and circumstances of each particular case and depends on the interaction between the various factors that are present in any given case. The most that I have been able to detect from the reading of the authorities is that there are certain features or badges which may point to one conclusion rather than another. In relation to transactions such as this, that is to say a one-off deal with a view to making a capital profit, there do seem to be certain things which the authorities show have been looked at. For convenience I will refer to them in a moment. But I would emphasise that the factors I am going to refer to are in no sense a comprehensive list of all relevant matters, nor is any one of them, so far as I can see, decisive in all cases. The most they can do is provide common sense guidance to the conclusion which is appropriate.'*

18. The Appellant alleged that her health deteriorated from 1998 and she is now unable to pay tax. Neither allegation is relevant to the question whether at the time of acquisition of the Subject Property the intention of the Appellant was to acquire and hold the Subject Property on a long term basis.

19. For the reasons we have given, the Appellant has not proved any of the following and her case of capital asset fails:

(a) that at the time of the acquisition in January 1996, the intention of the Appellant was to acquire and hold the Subject Property on a long term basis, whether for her own residence, whether to solve any alleged crowding problem at Property 1, whether because of any alleged disharmony with her daughter-in-law, whether to grow old in, or at all;

(b) that such intention was genuinely held, realistic or realisable.

20. The Appellant has not discharged the onus under section 68(4) of the IRO of proving that the assessment appealed against is excessive or incorrect. We dismiss the appeal and confirm the assessment as confirmed by the Commissioner.