

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D97/00

Profits tax – whether profits from the sale of a property assessable to profits tax – whether the sale of a property was a sale of capital asset or trading stock – testing the taxpayers’ assertion against the surrounding circumstances – section 68(4) of the Inland Revenue Ordinance (‘IRO’).

Panel: Ronny Wong Fook Hum SC (chairman), Lily Yew and William Zao Sing Tsun.

Date of hearing: 20 July 2000.

Date of decision: 28 November 2000.

This was an appeal by the taxpayers, a couple and a father in law, against the relevant profits tax assessment relating to the sale of a property (‘the Property’) among various properties owned by them and/or with their family. The main issue was whether it was acquired by the taxpayers as a capital asset or a trading stock.

Held:

1. The principles were clear. The Board had to ascertain the intention of the taxpayers at the time when the Property was purchased. The Board had to be satisfied that their intention was to purchase the same as their residence and such intention was on the evidence ‘genuinely held, realistic and realisable’ : All Best Wishes Limited v CIR 3 HKTC 750.
2. The Property was sold in less than one month of its purchase. Such rapid disposal was a strong indicia that the parties did not have a settled intention but embarked upon these transactions in the course of their trading activities.
3. The Board was given various accounts as to the reasons leading to such rapid purchase and disposal. No contemporaneous record had been placed before the Board to indicate which of those conflicting versions represented the truth. If the purchase was indeed part of the family plan of the taxpayers, they did not place any evidence before the Board to indicate how they financed the purchase and how they disposed of the proceeds of sale.

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4. The onus of proof rested squarely on the taxpayers. They had not discharged the burden in displacing the inference of trade arising from the speed whereby the unit was sold.

Appeal dismissed.

Cases referred to:

All Best Wishes Limited v CIR 3 HKTC 750

Cheung Mei Fan for the Commissioner of Inland Revenue.
Taxpayers in person.

Decision:

1. Mr A and Mrs A are husband and wife. Amongst their children are:
 - (a) their daughter Ms B.
 - (b) their son Mr C.
 - (c) their further son Mr D who married Mrs D on 1 March 1996.
2. By an agreement for sale and purchase dated 10 July 1991, Ms B and Mrs A purchased as joint tenants a flat at Housing Estate E [' Property 1 '] for \$1,393,000. The purchase was financed by a loan extended by Bank F in their favour in the sum of \$1,250,000.
3. By an agreement for sale and purchase dated 20 July 1995, , Mr A, Mrs A, Mr C and Mr D purchased as joint tenants another flat at Housing Estate E [' Property 2 '] for \$2,797,300. Mr A, Mr C and Mr D were nominated beneficial owners of Property 2 on 21 August 1995.
4. By an agreement for sale and purchase dated 23 December 1996, Mr D and Mrs D purchased as joint tenants a third flat at Housing Estate E [' Property 3 '] for \$2,280,000.
5. On or about 24 January 1997, Mr D purchased a flat in District G [' Property 4 '] for \$1,300,000
6. By a provisional agreement dated 15 February 1997, Mr A, Mr D and Mrs D purchased a flat in District H [' Property 5 '] as joint tenants for \$2,850,000. By a provisional agreement dated 10 March 1997, Mr A, Mr D and Mrs D sold Property 5 for \$3,460,000. This

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appeal relates to the liabilities of the Taxpayers for profits tax in respect of their gains arising from their dealings with Property 5.

7. On 19 March 1997, Mr and Mrs D sold Property 3 for \$3,200,000.

8. By an agreement for sale and purchase dated 1 April 1997, Mr D and Ms I purchased as tenants in common another flat at Housing Estate E [' Property 6 '] for \$5,020,000. The purchase was financed by a mortgage loan extended by Bank J.

9. On 2 June 1997, Mr D purchased a unit in District H [' Property 7 '] for \$1,770,000. This flat was subsequently sold on 23 September 1998 for \$1,188,000.

10. Mr A was a quality controller. His earnings for the years ending 31 March 1996 and 31 March 1997 were respectively \$139,060 and \$160,938.

11. According to the returns submitted by Mr D to the Revenue, his earnings as an employee of various architect firms and other institutions for the relevant years of assessment were as follows:

Year of assessment	Income \$
1994/95	336,320
1995/96	403,517
1996/97	438,379
1997/98	526,762

12. Mrs D was a secretary and her earnings for the relevant years of assessment were as follows:

Year of assessment	Income \$
1995/96	61,174
1996/97	22,950
1997/98	103,851.5

Representations made by the Taxpayers as to their intention in dealing with the various properties

13. In relation to Property 1 : By letter dated 15 May 1999, Mr A informed the Revenue that this flat belonged to his daughter Ms B. He moved into this flat in April 1998.

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14. In relation to Property 2 : By the said letter dated 15 May 1999, Mr A informed the Revenue that this flat belonged to his son Mr C who was solely responsible for the discharge of the mortgage instalments. He resided in this flat between June 1996 and April 1998.

15. In relation to Property 3

- (a) This Flat was of an area of 572 square feet with two bedrooms. It was purchased as the residence of Mr D and Mrs D.
- (b) In April 1998, Mr D explained to the Revenue that they were newly married when this unit was purchased. They planned to have a baby. Most of their family members were living in Housing Estate E. This unit was acquired ‘ so that we might live near to our family members who could help us to take care of the “baby” ’. It was sold because Mr A reckoned that the *fung shui* of this unit ‘ was very bad and even unacceptable ’.
- (c) By letter dated 4 July 1998, Mr D explained that he resided with his parents in Property 2 after his marriage in March 1996. He wanted to have his own flat. He selected Housing Estate E as he wished to be close with members of his family. An estate agent contacted him one evening at the end of November 1996. He inspected this unit with his wife and his mother. He signed the provisional agreement for sale and purchase at the prompting of the estate agent. His father then visited the unit and expressed disapproval with the *fung shui* of the unit. They moved into this unit after some renovation. His wife could not sleep because of the noise generated by traffic on a nearby highway. They decided to sell the unit as his wife was losing her job and Property 1 was available to them.

16. In relation to Property 4 : In his 15 May 1999, letter, Mr A explained this unit was purchased as their holiday home. Mr D and Mrs D moved into this unit for a short spell. They moved out of this unit in order to generate rental income to support the mortgage instalments.

17. In relation to Property 5

- (a) The area of this flat was 795 square feet with three bedrooms.
- (b) By letter dated 4 June 1998, Mr A, Mr D and Mrs D explained that:
 - (i) ‘ [Mr D] and [Mrs D] were newly married couple at the time we purchased [Property 5]. Having had a family plan to have a baby and having considered that most of our family members were living at ... Housing Estate E, we intended to acquire a flat near to there so

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that we might live near to our family members who could help us to take care of the “baby” .

- (ii) After the purchase, Mr A ‘ invited his good friend to visit the flat’ who advised that the flat’ s *fung shui* ‘ was so bad that it would affect the couple’ s chance of having baby.’
 - (iii) ‘ The other factor reinforce [sic] our determination to dispose of the property was that we heard from somebody that there would be new development to be built just in front of the captioned property.’
- (c) In a separate letter dated 12 July 1998, Mr A explained to the Revenue that:
- (i) He was residing with members of his family in Property 2. That unit was about 500 square feet in area. He was due to retire at the end of 1996. He would like to improve his accommodation with his retirement fund and his savings.
 - (ii) He was contacted by an estate agent in April 1997. This unit was apt for use as his retirement home. He decided to add the names of Mr D and Mrs D as co-purchasers in order to raise mortgage.
 - (iii) He discovered after his acquisition that the view of this unit might be blocked by nearby constructions. He sought advice from his estate agent who suggested that he could sell this unit as confirmor.
- (d) By letter dated 18 May 1999, Mr D explained that his father was on the verge of retirement. This unit was purchased so that he could share the same with members of his family. It was sold as his family members were not satisfied with the quality of this unit.

18. In relation to Property 7 : This unit was purchased for the purpose of setting up a studio wherein his wife could give art and piano lessons. This venture was a total failure. The unit had to be let out in order to reduce mortgage interest. [Per letter dated 4 July 1998].

The hearing before us

19. Mr D and Mrs D attended the hearing before us. Both gave sworn evidence in support of their appeal. Mr A did not appear and made no separate submission.

20. According to Mr D:

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- (a) He resided in Property 1 with his parents and his brother Mr C prior to his marriage. That flat was 764 square feet in area.
- (b) He moved to Property 2 after his marriage. That flat was only 599 square feet. Mr A did not get along with Mr C. Mr A therefore moved into Property 2. The accommodation in that flat was totally inadequate. He purchased Property 3 as his matrimonial home.
- (c) Property 3 was very noisy. His wife had difficulties sleeping at night. Mr A also wanted to live with them.
- (d) An estate agent introduced them to view Property 5. He decided to acquire this unit before selling Property 3 as property prices were on the rise. He wanted to have a unit in hand. Property 5 was bigger and the price was affordable.
- (e) Mr A took a relative of his to consider the *fung shui* of Property 5. He could not recall the *fung shui* objections raised by that relative.
- (f) His principal reason in selling Property 5 was because it was on the second floor facing a flat roof.

21. According to Mrs D:

- (a) The letter dated 4 June 1998 was drafted by a friend of the family. It was not her intention to make any reference to 'the most valuable sea view' as a reason leading to her disposal.
- (b) By about February 1997, she was aware that she might be losing her job but her contract was still on foot.
- (c) An estate agent contacted Mr A and Mr D at home in the evening of 15 February 1997. They were told of the availability of Property 5. She was consulted over the phone. She indicated that there would be no difficulty in meeting the mortgage instalments for the purchase of this unit. Mrs A and Ms B were not consulted prior to this purchase. They resisted the idea of living on the second floor. Their relationship became strained. They therefore decided to sell Property 5. They were advised by the estate agent to dispose of their interest through a confirmor sale.

The applicable principles

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22. The principles are clear. We have to ascertain the intention of Mr A, Mr D and Mrs D at the time when Property 5 was purchased. We have to be satisfied that their intention was to purchase the same as their residence and such intention is on the evidence ‘genuinely held, realistic and realisable’.

23. 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

24. Property 5 was purchased on 15 February 1997. It was sold on 10 March 1997. Such rapid disposal is a strong indicia that the parties did not have a settled intention but embarked upon these transactions in the course of their trading activities.

25. We were given various conflicting accounts as to the reasons leading to such rapid purchase and disposal.

- (a) The original case as outlined in their letter dated 4 June 1998 was that Property 5 was purchased to further the ‘family plan’ of Mr and Mrs D. There was no suggestion in that letter that they would share this flat with Mr A. Poor *fung shui* was given as one of the reasons leading to the disposal. This reason had hitherto been advanced for the sale of Property 3. Had this been an issue of importance, one would expect *fung shui* advice being sought prior to the purchase. The ‘most valuable sea view’ was the other reason put forward in support of the sale.
- (b) The second case was advanced by Mr A in his letter of 12 July 1998. Property 5 was going to be his retirement home. He was going to finance this purchase by his retirement funds and savings. The names of Mr and Mrs D were added to the purchase in order to facilitate mortgage application. The unit was sold because he was told by his friends that its view would be blocked by new building in the vicinity.
- (c) The third case was put forward by Mr and Mrs D at the hearing before us. The unit was sold because its purchase did not have the blessing of Ms B and Mrs A. Their principal objection was that the unit was on the second floor.

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26. No contemporaneous record had been placed before us to indicate which of these three conflicting versions represents the truth. If the purchase was indeed part of the family plan of Mr and Mrs D, they did not place any evidence before us to indicate how they financed the purchase and how they disposed of the proceeds of sale.

27. The onus of proof rests squarely on the Taxpayers. They have not discharged the burden in displacing the inference of trade arising from the speed whereby the unit was sold.

28. For these reasons, we dismiss the Taxpayers' appeal.