

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D98/97

Profits tax – whether profits derived from sale of properties assessable to profits tax – whether trading asset or capital asset – intention at the time of acquisition – subjective intention is to be tested against objective facts and circumstances.

Panel: Terence Tai Chun To (chairman), William Chan Wai Leung and Shirley Conway.

Date of hearing: 28 November 1997.

Date of decision: 21 January 1998.

The Commissioner made profit tax assessments for the years of assessment 1992/93 and 1993/94 in respect of the profit derived by the taxpayer from the sale of two properties (Property I and Property II).

The taxpayer had since 1990 resided rent free in Property VI (located in District C) owned by Mr E. The taxpayer married in July 1991 and soon after, his wife and he agreed that they should have a property for their own occupation preferably in District C in case Mr E wanted to resume possession of Property VI.

The taxpayer entered into a provisional agreement for the purchase of Property I (located in District A) in August 1991 and which the taxpayer sold as a confirmor in May 1992. The taxpayer purchased Property II (more than twenty years old and located in District B) in June 1993 and was sold in August 1993.

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 CIR 53 TC 461 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) The Board was satisfied that the taxpayer's purchase and sale of Property I and Property II amounted to an adventure in the nature of trade.

Property I

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The Board was not persuaded that the taxpayer had purchased Property I as an accommodation reserve but was for a quick profit. The Board found it far fetched that the taxpayer should purchase as his accommodation reserve an uncompleted unit in an area not of his preferred choice. As for the taxpayer's claim that he sold Property I in order to have sufficient funds to acquire a property in District C, no evidence was adduced to show that there was available property for sale in that district.

Property II

The Board was not satisfied that the taxpayer had bought Property II for letting or for any long term investment but had simply took the earliest opportunity to sell it for a profit. The Board found it incredible that an architect of the taxpayer's considerable experience did not find it necessary to make a more detailed inspection of the property to be used as his accommodation reserve and in which he was going to invest over \$5 million for a long term purpose and that he should not have realized the probability that defects were to be found in a building of this age.

Appeal dismissed.

Cases referred to:

Simmons v CIR 53 HKTC 461
All Best Wishes Limited v CIR 3 HKTC 750

Chan Wai Mi for the Commissioner of Inland Revenue.
Li Kin Hong of Pius Consulting Limited for the taxpayer.

Decision:

This appeal is brought by the Taxpayer against the determination of the Commissioner of Inland Revenue dated 24 April 1997 in respect of the profit tax assessments for the years of assessment 1992/1993 and 1993/1994 in respect of the profit derived by him from the sale of two properties, namely:

Property I and Property II

FACTS

The following facts had been agreed.

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During the relevant time, the Taxpayer had the following property transactions:

Location	District A <u>(Property I)</u>	District B <u>(Property II)</u>	District A <u>(Property III)</u>
Purchase			
Date of provisional agreement	28 August 1991	26 January 1993	22 June 1993
Date of assignment	Not applicable	26 April 1993	29 April 1994
Purchase price	\$2,382,300	\$5,010,000	\$3,986,016
Mortgage			
Loan amount	\$2,000,000	\$2,880,000	Nil
No. of monthly instalments	120	120	
Amount of monthly instalment	\$26,707.80	\$35,323.96	
Sale			
Date of provisional agreement	-	16 June 1993	Not applicable
Date of formal agreement for sale and purchase	12 May 1992	14 July 1993	
Date of assignment	22 December 1992	10 August 1993	
Selling price	\$3,300,000	\$6,550,000	

The occupation permit of Property I, which has a floor area of 945 square feet, was issued on 30 October 1992. The property was sold by the Taxpayer as a confirmor before he took possession of it.

Property II has a floor area of about 1,600 square feet. It was left vacant during the period of ownership by the Taxpayer.

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Property III has a floor area of 1,121 square feet. It was let out by the Taxpayer with effect from 1 May 1994 for a term of two years at \$16,000 per month.

The Taxpayer advised that he had derived net gains of \$667,123 and \$1,070,703 respectively from the sale of Property I and Property II.

The sequence of events prepared by the Taxpayer as set out on page 2 of the Notice of Appeal had also been agreed.

Date	Event
Since mid 1990	I dwell in District C
Mid 1991	I become married
28-8-1991	Provisional Agreement for purchase of Property I
12-5-1992	Sale & Purchase Agreement for selling of Property I
22-12-1992	Formal Assignment for selling of Property I
26-1-1993	Provisional Agreement for purchase of Property II
4-2-1993	Agreement for Sale & Purchase for purchase of Property II
26-4-1993	Formal Assignment for purchase of Property II
16-6-1993	Provisional Agreement for selling of Property II
22-6-1993	Provisional Agreement for purchase of Property III
14-7-1993	Sale & Purchase Agreement for selling of Property II
10-8-1993	Formal Assignment for selling of Property II
28-4-1994	Tenancy Agreement for Property III with contract commencement by 1-5-1994.
29-4-1994	Formal Assignment for purchase of Property III

The Taxpayer is represented by Mr Li Kin Hong, Pius, Accountant of Pius Consulting Limited. The Commissioner is represented by Miss Chan Wai Mi, senior assessor.

Before the Board, there were 3 bundles of documents, namely:

1. The Board's Bundle
2. The Revenue's Bundle
3. The Taxpayer's Bundle

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For easy identification and by agreement between Mr Li for the Taxpayer and Miss Chan for the Commissioner, various properties mentioned in the course of the hearing will be referred to as follows:

Property I	District A
Property II	District B
Property III	District A
Property IV	District A
Property V	District A
Property VI	District C
Property VII	District D

The Taxpayer's Case

The Taxpayer resides at District C with an area of about 1,700 square feet (Property VI).

In fact, he has been residing at Property VI since 1990.

Property VI is owned by Mr E.

Mr E is a relative of Mr F. Mr F is a close friend of the Taxpayer.

Mr E emigrated in 1978.

Mr E asked his relative Mr F to look after Property VI.

In 1990, Mr F also emigrated.

Before emigrating, Mr F asked the Taxpayer whether the Taxpayer would be interested to stay at Property VI rent free on condition that the Taxpayer would have to take care of the property. Mr E paid all the rates through autopay.

The Taxpayer agreed to stay at Property VI on these terms.

He got married in July 1991.

Soon after marriage, the Taxpayer and his wife realized that they should have a property of their own for residence in case they were asked to move out by Mr E.

In or about August 1991, development in District A was open for sale. This development was designed by the company for which the Taxpayer and his wife were working.

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Through the assistance of their boss, the developer was approached and eventually through internal allocation, the Taxpayer acquired a unit in District A with an area of about 945 square feet (Property I) as accommodation reserve.

The development, of which Property I forms part, was still under construction.

In May 1992, the Taxpayer sold Property I.

It was the Taxpayer's case that he sold Property I in order to have sufficient fund to purchase a property in District C, a locality for which he had a special liking.

In January 1993, in response to a newspaper advertisement, the Taxpayer made arrangement to view Property II. During his visit to Property II, he was impressed by its superb view. It was evening time at about 6:30 pm. He noticed that Property II was occupied by many people. He stayed around for about 10 minutes to check if the rooms were suitable. He did not make any further inspection of Property II. He then asked his agent to make a counter offer to the owner. Eventually, the Taxpayer agreed to purchase Property II for \$5,010,000. He took possession in April 1993 and immediately upon taking possession, he discovered that Property II was in a very bad state of repair. He noticed water stains on wall paper and underneath the wall paper, there were a lot of cracks. Flush water was slow and rusty and there was no hot water supply. Bath tub drainage was not working properly and there were water stains on window bays. The Taxpayer claimed that he did not realize that there were so many latent defects. His original intention was to let out Property II but in order to restore Property II into a proper state of repair, a sum close to \$500,000 would be required, which was beyond his expectation. The Taxpayer decided to dispose of Property II instead because he did not want to be saddled with repair problems which were bound to arise. He carried out a minimum amount of repair work just to make Property II lettable, such as replacing the wall paper, repainting the window bays, changing the shower and the geyser and washing the carpet. He succeeded in selling Property II in August 1993 for \$6,550,000.00.

The Revenue's case

Property I was sold by the Taxpayer as confirmor before the purchase was completed whereas Property II was sold in less than two months after the property was assigned to him. In view of the short periods of ownership and the rapid succession of transactions, there was a strong inference that Property I and Property II were bought for the purpose of re-sale at a profit.

The Taxpayer claimed that the purchase of Property I was for the purpose of an accommodation reserve. However Property I was still under construction and was not situated in an area of his preferred choice. At the time of purchase, there was no immediate fear either real or apparent that Mr E would want the Taxpayer to move out of Property VI so the Taxpayer had plenty of time to look for a property in District C, an area where he would like to have his home and his long term investment. There was strong doubt that the

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Taxpayer purchased Property I as an accommodation reserve. The Taxpayer sold Property I and made a handsome profit from a quick sale.

As to Property II, Miss Chan submitted that it was never the intention of the Taxpayer to use it as an accommodation reserve. It took the Taxpayer only ten minutes to make a decision to purchase Property II and if it were for the purpose of his accommodation reserve, the Taxpayer would certainly have made a proper inspection of the state of repair relating to the property. It was not credible that the Taxpayer would have failed to notice all the defects he mentioned if he had been minded to inspect the property properly. The Taxpayer made a speedy decision to purchase Property II, swiftly patched it up and resold it at a quick profit. Property II could not but be a trading stock of the Taxpayer.

THE LAW

1. The relevant sections of the IRO are quoted below:

(a) Section 14

‘Subject to the provisions of this IRO, 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 ...’

(b) Section 2

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

(c) Section 68(4)

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

2. Certain guiding principles have been established in decided cases.

(a) Intention at the time of acquisition is crucial

In considering whether an asset is a trading asset or a capital asset, one has to consider the intention which existed at the time to acquisition of the asset. In the case of Simmons v CIR 53 TC 461, Lord Wilberforce said at page 491:

‘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

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acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment?’

- (b) Subjective intention is to be tested against objective facts and circumstances

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 simple 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.’

CONCLUSION

The Taxpayer resides at District C, (Property VI).

The Taxpayer has been occupying Property VI as a licensee of the owner Mr E since 1990.

We were not informed of the precise terms of the licence except that the Taxpayer would have to take care of the property.

The Taxpayer married in 1991 and soon after marriage, the Taxpayer and his wife agreed that they should have a property for their own occupation preferably in District C in case Mr E wanted to resume possession of Property VI.

In about August 1991, the Taxpayer purchased Property I which was situated in District A, an entirely different area from District C.

Property I was still under construction and obviously could not be used as an alternative accommodation by the Taxpayer and his wife in case they were required by Mr E to move out from Property VI. The Taxpayer would have been better served if he acquired a property capable of being occupied. It was far fetched that the Taxpayer should purchase as his accommodation reserve an uncompleted unit in an area not of his preferred choice. The Taxpayer stated during examination in chief that both he and his wife decided to look

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for long term investment in the neighbourhood of District C which they found suitable. We were not persuaded that the Taxpayer purchased Property I as an accommodation reserve.

The Taxpayer claimed that he sold Property I in order to have sufficient funds to acquire a property in District C.

At the time of the sale of Property I, that is, in May 1992, no evidence was adduced to show that there was available property for sale in District C.

According to the Taxpayer's evidence, it was only in mid-January 1993 that the Taxpayer saw a newspaper advertisement relating to the sale of a property in District B, which was Property II.

We are satisfied that the reason for the Taxpayer to sell Property I in May 1992 before the property was completed was for a quick profit.

As to Property II, the Taxpayer said that he made a ten-minute inspection of Property II and decided to purchase it for \$5,010,000. He also said that his original intention was to let it out.

The Taxpayer claimed that he discovered that Property II was in a dilapidated condition only upon taking possession.

The Taxpayer enumerated a number of defects found.

Property II was more than twenty years old and it is incredible that an architect of the Taxpayer's considerable experience should not have realized the probability that such defects were to be found in a building of this age. It is even more incredible that the Taxpayer did not find it necessary to make a more detailed inspection of the property to be used as his accommodation reserve and in which he was going to invest over \$5,000,000 for a long term purpose. We are not satisfied that the Taxpayer bought Property II for letting or for any long term investment. The Taxpayer simply took the earliest opportunity to sell Property II for a profit.

We now turn to four property transactions referred to at the hearing.

Property III was a new flat in District A, purchased by the Taxpayer.

Property IV was another property in District A, purchased by the Taxpayer's wife with full knowledge and support of the Taxpayer.

Property V was a commercial property within District A purchased by the Taxpayer.

Property VII was a thirty-year-old building in District D, purchased by the Taxpayer.

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In his submission, Mr Li on behalf of the Taxpayer stated that the sale of Property IV and Property V in April 1997 was to enable the Taxpayer to have sufficient funds to acquire Property VI. This could hardly be the reason for the sale around April 1997.

According to the Taxpayer, there was an understanding between him and Mr E that if Mr E were to sell Property VI, the Taxpayer would be the first to be offered.

There was no evidence to show that Mr E made any special offer to the Taxpayer about the sale of Property VI.

As a matter of fact, in April 1997, Mr E was in no position to sell Property VI because Mr E and the Government had not reached agreement on the amount of premium which must first be paid before Mr E was able to dispose of Property VI.

The Taxpayer's purchase of Property VII must be treated with caution.

Property VII was a thirty-year-old building.

It was difficult to comprehend why the Taxpayer should have been interested in another thirty-year-old building after his experience with Property II. When he disposed of Property II, he was frustrated by all the defects of an old building and declared upon purchasing Property III, that keeping a new apartment as long term reserve would be less troublesome.

It was to be noted that District D was not his chosen locality and yet he paid \$16,000,000 for an apartment in a thirty-year-old building.

The purchase of Property VII was opposed to the Taxpayer's declared wish to have his long term investment in the area of his choice. It was also inconsistent with his lack of confidence in old buildings.

We conclude that these four transactions cannot be of any help to the Taxpayer in showing that Property I and Property II were acquired for investment purposes and that the profit from their sale was capital in nature and not chargeable to tax.

In all the circumstances, we find that the purchase and sale of Property I and Property II by the Taxpayer amounted to an adventure in the nature of trade.

Accordingly, we dismiss the appeal and confirm the profits tax assessments for the years of assessment 1992/93 and 1993/94.