

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D39/99

Profits Tax – whether gain on sale of property capital or trade in nature.

Panel: Kenneth Kwok Hing Wai SC (chairman), Eugene Ho and Lily Yew.

Date of hearing: 16 June 1999.

Date of decision: 28 July 1999.

The taxpayers are husband and wife. They purchased the Subject Property from the developer at the price of \$1,447,400 on March 1991 and sold it at \$2,830,000 on 16 April 1992.

The taxpayers claimed that the gain on the sale of the Subject Property was capital in nature. They intended to be use the Subject Property as a place of residence but they were not able to put it into use. In March 1991, they purchased three properties and claimed that all the properties were acquired for residential purpose. The taxpayer did not call any evidence at the hearing.

Held:

By calling no evidence, the taxpayer failed to discharge its burden of proving that the assessment was wrong. Considering the surrounding circumstances, the Board also found the taxpayers' assertions are to their knowledge untrue.

Appeal dismissed and a cost of \$5,000 charged.

Wong Ki Fong for the Commissioner of Inland Revenue.

Ng Hang Fong of Messrs Wong Lam Leung & Kwok for the taxpayer.

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Decision:

1. This is an appeal against the determination dated 12 January 1999 by the Commissioner of Inland Revenue, rejecting the Taxpayer's objection against the profits tax assessment for the year of assessment 1992/93 dated 16 December 1994 showing assessable profits of \$1,128,891 with tax payable thereon of \$169,333 and increasing the assessable profits to \$1,164,944 with tax payable thereon of \$174,741. The gain arose from the sale of a residential property at District A, Hong Kong Island ('the Subject Property').

The facts

2. Based on the statement of agreed facts and the documents produced at the hearing of the appeal, we make the following findings of facts.

3. The Taxpayers are husband and wife.

4. From 13 March 1986 until 4 April 1991, the wife was the sole proprietress of a beauty saloon at District B, Hong Kong Island.

5. From 12 May 1986 to 21 June 1989, the Taxpayers were the registered owners of a residential property at District B, Hong Kong Island.

6. From 11 July 1990 to 19 February 1991, the husband and another were the proprietors of a saloon in District C, Hong Kong Island.

7. By a memorandum for sale dated 11 March 1991, the Taxpayers agreed to purchase the Subject Property from the developer at the price of \$1,447,400.

8. By a tenancy agreement dated precisely the same date as the date of the memorandum for sale, that is, 11 March 1991, the husband rented a shop ('the Shop') in District D, Hong Kong Island, for a term of 30 months commencing on 11 March 1991. This was the business address of the hair saloon owned by the husband who commenced business there on 4 April 1991.

9. The formal agreement made by the Taxpayers to purchase the Subject Property is dated 16 March 1991.

10. By a provisional agreement dated 18 March 1991, that is, 7 days after the date of the memorandum for sale, the wife agreed to purchase a residential property at District E, Kowloon ('Property 2'), at the price of \$1,319,000.

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11. By a provisional agreement dated 26 March 1991, that is, 15 days after the date of the memorandum for sale, the husband agreed to purchase a residential property at District F, Kowloon ('Property 3'), at the price of \$1,756,400.
12. Within a period of 15 days in March 1991, the Taxpayers had agreed to purchase a total of 3 residential properties and the husband had rented the shop premises of his hair salon.
13. By a formal agreement dated 9 April 1991, the husband agreed to sell Property 3 at the price of \$1,756,400.
14. By a provisional agreement dated 4 May 1991, the wife agreed to sell Property 2 at the price of \$1,409,000.
15. By a formal agreement dated 16 July 1991, that is, 4 months 5 days after the date of the memorandum for sale, the Taxpayers agreed to purchase a residential property in District D, Hong Kong Island ('Property 4'), at the price of \$1,440,000. The Taxpayers completed the purchase on 26 September 1991.
16. By a formal agreement dated 22 October 1991, that is, 7 months and 11 days after the date of the memorandum for sale, the wife agreed to purchase a residential property at District G, Kowloon, at the price of \$1,072,000.
17. The Taxpayers financed the purchase of the Subject Property by an equitable mortgage loan of \$1,302,660 from a bank which charged interest at 10% per annum. The loan was repayable by 180 monthly instalments of \$13,998.45.
18. Occupation permit for the Subject Property was issued on 22 November 1991.
19. On 30 January 1992, the Taxpayers completed the purchase of the Subject Property and a mortgage was charged on the Subject Property.
20. By a provisional agreement dated 17 March 1992, the Taxpayers agreed to sell the Subject Property at the price of \$2,830,000.
21. The sale of the Subject Property was completed on 16 April 1992.
22. In response to the assessor's enquiries, the husband claimed that the gain on sale of the Subject Property was \$1,128,891; that the gain on sale of the Subject Property was capital in nature; that the Subject Property was sold because of change of residence to Property 4; that he and his wife were working in the beauty profession; that originally they intended to open their shop in the area of the Subject Property; that there was no suitable shop premises in the vicinity; that in addition, their customers were centred in District C and District D; that they had no alternative but to sell the Subject Property and buy Property 4;

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that at the same time they had rented a shop premise nearby and continued with their beauty saloon business.

23. The assessor did not accept that the gain on the sale of the Subject Property was capital in nature, taking the view that the Taxpayers had embarked on an adventure in the nature of trade and raised an estimated profits tax assessment for the year of assessment 1992/93 showing estimated assessable profits of \$1,128,891, with tax payable thereon of \$169,333.

24. The Taxpayers objected to the assessment on the ground that the gain on sale of the Subject Property was capital in nature.

25. In reply to the assessor's enquiries, the Taxpayers, through their tax representatives (who also represented the Taxpayers at the hearing of the appeal), asserted that the Subject Property was intended to be used as a place of residence; that it was subsequently not used as such and was left vacant for 15 days; that the Taxpayers were not able to put the Subject Property into use; that the Taxpayers had purchased the Subject Property on 15 March 1991 (sic) when it was still under construction; that 'around the time before the issuance of the occupation permit, [the Taxpayers] set up their beauty saloon business at' the address of the Shop; and that 'Finally, [the Taxpayers] sold [the Subject Property] and resided in District H, Hong Kong Island temporarily from April 1991 to September 1991' and that the Subject Property 'was sold as its location was too far away from [the Taxpayers'] place of business located at [the Shop]'.

26. The wife claimed that Property 2 in respect of which she entered into the provisional agreement dated 18 March 1991 to buy was for self-residential purpose. The husband claimed that Property 3 in respect of which he entered into the provisional agreement dated 26 March 1991 to buy was acquired for self-residential purpose.

27. In the Commissioner's determination dated 12 January 1999, she revised the profits tax assessment for the year of assessment 1992/93 by adding overstatement of legal fee, overstatement of interest and commission to arrive at a revised assessable profits of \$1,164,944, with revised tax payable thereon of \$174,741.

28. By notice of appeal dated 10 February 1999, the Taxpayers through their tax representatives appealed on the ground that 'the profits on sale of [the Subject Property] should be capital in nature and should not be chargeable to tax'.

The Taxpayers' case

29. The tax representatives notified the Board of Review that the 'Taxpayers will not attend the hearing in person' and that 'there will be no witness to attend the hearing'; and sought to produce a 'witness statement' of the wife. Miss Wong who appeared for the Respondent (the CIR) said that she would only accept it as a document or as a submission of the Taxpayers, instead of a witness statement. The 'witness statement' deals with issues

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which are crucial to this appeal, but the Respondent is denied any opportunity to cross-examine the wife. The tax representatives had put forward no intelligible reason why we should accept the ‘witness statement’ as evidence and we declined to admit it as evidence.

30. The tax representatives did not call any witness and did not produce any documents. They indulged in making assertions of fact in the course of their ‘submission’.

Relevant provisions

31. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is incorrect is on the Taxpayer. 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.

Our decision

32. The issue is whether the Taxpayers have discharged the onus of proving that the assessment appealed against is incorrect in that they acquired the Subject Property as a capital asset for self-residence.

33. Sub-paragraph (4) of the reasons given by the Commissioner in his determination states that:

‘ Other than mere assertions, [the Taxpayers] failed to give any documentary evidence in support of their claim. The assessor’s letter at Appendix A left unanswered. In March 1991 [the Taxpayers] either individually or collectively bought 3 properties – the Subject Property on 11 March 1991, [Property 2] on 18 March 1991 and [Property 3] on 26 March 1991. All properties were claimed to have been acquired for [the Taxpayers’] residential purpose. Moreover, on the same date when [the Taxpayers] acquired the Subject Property, that is, on 11 March 1991 ... [the husband] made a tenancy agreement for the business premise of his [hair saloon at the Shop] in District D. The facts speak for themselves. When [the Taxpayers] acquired the Subject Property, they were not committed to use it as their residence. Its distant location was merely an excuse. The claim of non-availability of shop premise for his [beauty saloon] in [the Subject Property area] is totally without merit as [the husband] made a tenancy agreement for the business in District D on the very date when the Subject Property was acquired. On the other hand, there is no evidence that [the Taxpayers] had the financial capability to hold the Subject Property for the long term.’

34. These appear on their face to be cogent reasons, but the Taxpayers have not begun to discharge the burden of proving that the assessment is incorrect in that the Subject

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Property was acquired as a capital asset. Facts are to be proved by evidence, not by assertions made in the course of a submission.

35. In our decision, the assertions that the Taxpayers had no alternative but to sell the Subject Property and buy Property 4 and that at the same time they had rented a shop premise nearby and continued with their beauty saloon business are to the knowledge of the Taxpayers untrue. The date of the tenancy agreement is 11 March 1991 and the Shop commenced business on 4 April 1991. The formal agreement to buy Property 4 was not made until 16 July 1991, 3 months 12 days after the Shop commenced business. The provisional agreement to sell the Subject Property is dated 17 March 1992, more than 8 months after the date of the formal agreement to buy Property 4, and more than 5½ months after the purchase of Property 4 had been completed on 26 September 1991.

36. The assertions that ‘around the time before the issuance of the occupation permit, [the Taxpayers] set up their beauty saloon business at’ the address of the Shop; and that ‘Finally, [the Taxpayers] sold [the Subject Property] and resided in District H temporarily from April 1991 to September 1991’ are also to the knowledge of the Taxpayers untrue. The husband made the tenancy agreement to rent the Shop on the very same date as the date of the memorandum for sale of the Subject Property and commenced business at the Shop on 4 April 1991, not ‘around the time before the issuance of the occupation permit’ which was not issued until November 1991. The provisional agreement made by the Taxpayers to sell the Subject Property is dated 17 March 1992, 6 months after September 1991. Thus it is not true that the Taxpayer ‘sold [the Subject Property] and resided in District H temporarily from April 1991 to September 1991’.

37. We dismiss the appeal and confirm the assessment as increased by the Commissioner by his determination.

Order on costs

38. In our decision, this appeal is obviously unsustainable and bound to fail. Pursuing such a hopeless appeal can only waste the time and resources of the Board of Review and is clearly an abuse of the process. Prosecuting an appeal by asserting facts which are to the knowledge of the Taxpayers untrue is a most serious aggravating factor. Pursuant to section 68(9) of the IRO, we order the Taxpayers to pay the sum of \$5,000 as costs of the Board, which \$5,000 shall be added to the tax charged and recovered therewith.