

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D102/96

Profits tax – sale of property as capital asset – intention to use as matrimonial home – fixed not provisional.

Panel: Christopher Chan Cheuk (chairman), Chiu Chun Bong and Philip Lam Bing Lun.

Date of hearing: 24 January 1997.

Date of decision: 5 March 1997.

The taxpayers claimed that they purchased the property for their future matrimonial home. The mother of one of the taxpayers agreed to give financial support but passed away before completion. The taxpayers found it difficult to pay instalment as the property could not be let out easily to supplement instalment payment. The property was sold. Two months later they purchased another property which was let out. On expiry of the term of the tenancy the taxpayers married and moved in and lived there as matrimonial home.

Held:

The taxpayers had firm intention of using the subject property as matrimonial home though their plan depended upon objective circumstances beyond their control. There were some setbacks to their plan; they made diligent effort to remedy but without success. The Board considered all the evidence as a whole and was satisfied that their intention was definite and not provisional.

Appeal allowed.

Cases referred to:

Simmons v IRC [1980] 1 WLR 1196
All Best Wishes Limited v CIR 3 HKTC 750
Cunliffe v Goodman [1950] All ER 720

Tam Tai Pang for the Commissioner of Inland Revenue.
Taxpayers in person.

Decision:

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1. This is an appeal against the determination made by the Commissioner made on 9 February 1996 in respect of profits tax assessment for the year of assessment 1993/94 in the sum of \$627,145 and tax payable thereon in the sum of \$94,071. The profit arose out of purchase and sale of a property ('the Subject Property').

2. Both Taxpayers, Mr A and Madam B, appeared in person and they were assisted by a certain Mr C who was a public accountant. He sat next to the Taxpayers throughout and chatted with the Taxpayers intermittently but he gave no evidence and made no submission. This was rather unusual. The Board believes that Mr C had been advising the Taxpayers in this case. Whether it was proper for a professional to conduct a case in such a way the Board makes no observation.

PROCEEDINGS

3. The parties agreed the facts of the case before us which were set out in paragraphs (1) to (8) of the Commissioner's determination aforesaid. The parties also agreed to the production of the bundle of documents consisting of 58 pages together with the documents marked as exhibits 'I1', 'I2', 'I3', 'I4', 'J' and 'K'.

4. Both Taxpayers gave evidence and were cross-examined by Mr Tam Tai-pang for the Revenue.

AGREED FACTS

5. On 10 April 1993 the Taxpayers entered into a provisional agreement to purchase the Subject Property at a consideration of \$1,840,150 which was to be paid in the following manner:

Temporary deposit upon signing the provisional agreement	\$92,008
Further deposit to be paid on or before 17 May 1993	\$92,007
Further deposit to be paid within 7 days after issue of occupation permit	\$92,008
Balance to be paid by 240 monthly instalments as from 16 May 1993 at \$14,325.30 each	1,564,127
Total	<u>\$1,840,150</u>

At the time of purchase the Subject Property was still in the process of construction.

6. On 4 January 1994 the Taxpayers entered into a provisional agreement to sell the Subject Property at \$2,650,000. At that time the Subject Property was not yet ready for occupation.

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7. The assessor considered that the purchase and sale of the Subject Property by the Taxpayers amounted to an adventure in the nature of trade and in the absence of a profits tax return, raised on the Taxpayers profits tax assessment for the year of assessment 1993/94.

8. The Taxpayers, through a representative, objected to the assessment on the ground that the profit was a capital gain.

TESTIMONY

9. Both Madam B and Mr A gave evidence on oath one after the other. Madam B is a teacher and has been in the profession for 6 years. Mr A is an insurance sales agent. Both of them have received very good education.

10. They claimed that in April 1993 they purchased the flat because they wanted to get married and the developer offered easy payment terms which were most suitable to their own circumstances. They planned to marry after possession of the premises was delivered to them, and would move in together with Madam B's parents and younger sister.

11. Her mother gave her full assurance that in case they needed money she would lend it to them. Unfortunately, the mother passed away in August 1993, four months after the acquisition of the Subject Property. Madam B claimed that she had to postpone the marriage for a period of two years according to the Chinese customs and tradition. She also lost the possible financial support from her mother, if required.

12. They continued to make instalment payments until December 1993 when the date of occupation permit could be more accurately estimated. Although the clause in the provisional agreement stated that the balance could be paid by 240 instalments the standard form bore a chop mark which, inter alia, showed that the longest payment term would be twelve years which meant that they were allowed to pay 120 instalments only and for each instalment they had to pay more. They tried to make arrangement with banks but were not successful. They were afraid that they could not meet the financial obligation and decided to rent out the Subject Property. The agent found them a buyer instead of a tenant. As last they decided to sell it.

13. Shortly afterwards in January 1994 they purchased another property ('Property X') which was larger in size and higher in price. After completion of the purchase they let it out. When the tenancy expired they got married and they moved into the premises and lived with Madam B's father and sister.

LAW

14. Mr Tam for the Revenue gave very detailed points of law and urged the Board to adopt his submission. The list of authorities began with a quotation by Lord Wilberforce in Simmon v IRC [1980] 1 WLR 1196 which states: '*Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of acquisition*

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

15. He further elaborated the method of testing one’s intention by citing the often quoted passage in the judgment by Mortimer, J in All Best Wishes Limited v CIR 3 HKTC 750 at page 771 which the Board does not propose to repeat. Then, Mr Tam dealt with the characteristic of the required intention by quoting a short passage from the judgment by Cohen LJ in Cunliffe v Goodman [1950] All ER 720 at page 723:

‘It is clear that the intention which must be proved ...is a definite intention. This intention may be revocable, but it must not be provisional.’

16. Mr Tam asked us to draw the conclusion that the Taxpayers’ intention to use the Subject Property as their home at the time of acquisition was not a fixed intention but a provisional one which depended upon a number of contingencies, for example, the financial support from Madam B, the date of occupation permit and the time of marriage.

FINDINGS

17. If Madam B had been more frank and open in giving her evidence the case would have been a lot simpler than it is now and it would have saved a lot of cross-examination by Mr Tam. For example, she said that because of her mother’s death she lost the possible financial support: this is easily understandable. But she went on to say that according to the old Chinese custom and tradition for which, she followed, a person should not marry within two years of the death of one’s parent. With due respect to her academic achievement and profession the Board finds it difficult to believe that she would think such unreasonable custom should be upheld and that she followed it without reservation. There are other instances which go beyond reason. It is fortunate for her these are minor matters; otherwise, the result might have been different.

18. What the Board has to enquire is whether the Taxpayers had clear and firm intention to use as their matrimonial home at the time of acquisition and whether such intention was unequivocal. After considering all evidence the Board believes that at the time when the Taxpayers acquired the Subject Property they had fixed intention of using it as their future matrimonial home and also believes that Madam B’s mother would give them financial support if required. Her death did shatter their dream and at least definitely upset their plan: they lost the forthcoming financial support and this put them into fear. The family had to spend some money on funeral expenses and Property Y where they resided would be tied up for some time as it had been registered in the sole name of the mother and could not be sold or mortgaged until probate or letters of administration were granted by court. The whole process sometimes took a year or two.

19. They looked for alternative and planned to rent out the Subject Property but without much success. At last they sold it at a profit. Soon after that, they purchased another property with some borrowed money and the property was easily let out after completion. This caused us some trouble: as they could borrow money to buy the other

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property, why did they worry about completion of the purchase of the Subject Property in December 1993? The Taxpayers did not give any direct explanation for this. She said that Property X had been already completed and was ready for occupation so they could let it out easily and could procure some income in form of rent to subsidise their instalment payment. The ultimate result supports what she said.

20. The property was let out on 20 March 1994 for a fixed term of one year with an option for renewal for another year and the rent was \$13,000 which went a long way in contributing to the monthly instalment payment of \$21,000 each for the mortgage loan. Later they recovered possession and got married on 7 January 1996. The married couple and Madam B's father and sister all lived under the same roof at Property X.

21. The Board finds it that it is a genuine case of a young couple planning for the future --- to buy a flat and to marry after possession would be delivered to them but their plan was frustrated by the death of Madam B's mother and at least, had to be postponed until some time later when they felt more at ease in doing so. They never purchased or sold any property except those mentioned above. The Board was impressed by the fact that the Taxpayers were ignorant of many sale and purchase practices. This shows that they were not speculators or traders who would be more careful in calculating the profits rather than their own ability to pay.

22. Taking all evidence as a whole the Board comes to the conclusion that the Taxpayers purchased the Subject Property not for the purpose of trading but as their future residence. Their intention was not provisional but a fixed one. The implementation of such intention was not revoked but postponed because of the change of circumstances and was materialised in a different property at a later time.

DECISION

23. For the findings and reasons given above, the Board allows the appeal and sets aside the determination made by the Commissioner and the assessment for profits tax for the year of assessment 1993/94 in respect of the sale of the Subject Property.