

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D46/99

Profits Tax – sale of property – whether profits derived from the sale of the property assessable to profits tax – intention at the time of purchase.

Panel: Ronny Wong Fook Hum SC (chairman), Ho Kai Cheong and David Wu Chung Shing.

Date of hearing: 11 May 1999.

Date of decision: 16 August 1999.

The taxpayer is a private company incorporated in Hong Kong. Mr and Mrs A were the directors and the only two shareholders of the taxpayer. Mr A made all the decisions. Mr A's first and second attempt to immigrate to Country C were not successful. On 8 October 1990, the taxpayer purchased Property 1. Between November 1990 and September 1991, Mr A's family resided in Property 1. Property 1 was sold by the taxpayer on 8 January 1992 after Mr A's family's move into quarter of a government authority in September 1991.

By 28 May 1992, Mr A's third application for immigration to Country C was rejected. Mr A then made his fourth attempt for immigration in July 1992. In the meantime, Mr A was granted the UK right of abode in November 1992. The taxpayer purchased Property 2 on 26 March 1993. Mr A's fourth attempt for immigration to Country C was approved on 28 June 1993. By letter dated 30 November 1993, the Government informed Mr A's family to vacate the quarter on or before 1 March 1995 to make way for the demolition.

The taxpayer sold Property 2 as confirmor on 24 December 1993. On 28 January 1994, the taxpayer purchased Property 3. Mr A's family landed in Country C on 1 February 1994. Mrs A stayed in Country C with her son. Mr A returned to Hong Kong in the end of February 1994. He resided in Property 3 for the period between February 1994 and April 1995. The issue is whether the taxpayer is liable for profits tax arising from the gains it obtained through its dealings with Property 2.

Held:

- (1) The Board has to determine whether the taxpayer had a settled intention to acquire Property 2 as long term investment for use by its directors as their residence. Mr A's persistent quest for Country C's visa does cast doubts on his alleged adherence to Hong Kong after obtaining the right of abode in November 1992.

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- (2) The Board was not convinced by the Revenue's argument that the taxpayer did not have the financial capacity to hold Property 2 on a long term basis. However the Board found that there are two matters that turned the scale against the taxpayer. Firstly, the position of Mr A's family at the time of purchase was one of uncertainty and it was unlikely for the taxpayer to make an arrangement on a long term basis. Secondly, the opportunity to purchase was purely fortuitous. The acquisition was not the result of careful planning.

Appeal dismissed.

Chow Cheong Po for the Commissioner of Inland Revenue.

Stephen Yam instructed by Kennedy Tang, Arthur Li & Co for the taxpayer.

Decision:

Background

1. The Taxpayer is a private company incorporated in Hong Kong on 24 January 1984. In its profits tax return for the year of assessment 1994/95 the Taxpayer described the nature of its business as 'property investment for letting and motor vehicle letting'. At all material times the authorised and paid up capital of the Taxpayer was \$10,000 and its directors were Mr and Mrs A.
2. Mr A was an executive with Company B. He has extensive work experience in real estate.
3. In about the final quarter of 1988, Mr A made his first attempt to immigrate to Country C. It was unsuccessful. The commission of Country C took the view that given his extensive real estate experience his application should be assessed under the occupational group of real estate management. Mr A sought to apply on the basis of a sales manager.
4. Mr A made his second attempt to immigrate shortly after the June 4 incident in 1989. This second attempt was rejected on 25 September 1990.
5. Between 1 January 1990 to November 1990, Mr and Mrs A resided in a unit at District D together with their son.
6. On 8 October 1990 the Taxpayer purchased another unit at District D ['Property 1'] for \$1,500,000. Between November 1990 and September 1991, Mr A's family resided in Property 1.

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7. Mr A's family moved to the staff quarters of a government authority ['the Quarters'] in September 1991. The Quarters were made available to Mrs A as part of her then contract of employment as an officer with the government authority. Property 1 was sold by the Taxpayer on 8 January 1992 for \$2,720,000 after Mr A's family's move into the Quarters.

8. By letter dated 28 May 1992, the consulate general of Country C rejected Mr A's third application for admission to Country C. Mr A was however informed that his application will be reconsidered should the same be supported by an approved undertaking from his relative.

9. Mr A made his fourth attempt for immigration in July 1992. The application was lodged in Country E. It was an application supported by his brother in Country C. By letter dated 11 February 1993, Mr A was asked to attend an interview in Country E on 19 April 1993. In the meantime, Mr A was granted the UK right of abode in November 1992.

10. By an agreement dated 26 March 1993, the Taxpayer purchased a unit at District F ['Property 2'] for \$6,098,540 payable as follows:

- (a) \$304,927 upon the signing of the agreement.
- (b) \$914,781 within 14 days after issuance of the occupation permit.
- (c) 11 instalments of \$50,821 each on the first day of each month commencing on 1 January 1994.
- (d) 1 instalment of \$50,823 on 1 December 1994.
- (e) \$4,268,978 on or before 1 January 1995.

Property 2 is of an area of approximately 1,200 square feet.

11. Mr A's fourth attempt for Country C's visa was a successful one. The application was approved on 28 June 1993.

12. By letter dated 30 November 1993, the government authority informed all occupants of the Quarter that the quarter 'will be demolished in 1995. The building will be handed-over to the Territory Development Department for clearance in April 1995. You are therefore required to vacate the flat on or before 1 March 1995 to make way for the demolition.'

13. On 24 December 1993, the Taxpayer sold Property 2 as confirmor for \$9,800,000. This was before the grant of the occupation permit in respect of this flat on 7 February 1994. The Taxpayer expended a total of \$1,388,530 in respect of this purchase

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made up as to \$1,219,708 (\$304,927 + \$914,781) in payment of the purchase price and as to \$168,822 for legal fee and stamp duty.

14. On 3 January 1994, the Taxpayer bought two car parks in the complex at District F for \$650,000 each. The first of these car parks was resold by the Taxpayer on 31 March 1994 for \$880,000. The other car park was resold on 28 April 1994 for \$860,000. The right to acquire these two car parks arose by virtue of the Taxpayer's acquisition of Property 2.

15. On 28 January 1994, the Taxpayer purchased a unit and a car parking space in District G ['Property 3'] for \$4,930,000.

16. Mr A's family landed in Country C on 1 February 1994. Mrs A stayed in Country C with her son. Mr A returned to Hong Kong in the end of February 1994. He resided in Property 3 for the period between February 1994 and April 1995.

17. The earnings of Mr and Mrs A for the years between 1990 and 1994 were as follows:

	Period	Employer	Income
Mr A	1-4-1990 – 31-3-1994	Nil	Nil
Mrs A	1-4-1990 – 31-3-1991	The government authority	\$177,165
	1-4-1991 – 31-3-1992	Ditto	\$205,736
	1-4-1992 – 31-3-1993	Ditto	\$236,310
	1-4-1993 – 31-3-1994	Ditto	\$274,386

18. The income of the Taxpayer for the years 1992 – 1995 was as follows:

	1992	1993	1994	1995
Consultancy fee	\$1,085,014	\$1,429,613		
Rental income			\$300,000	\$150,000
Hire of motor vehicle			\$160,404	\$116,808
	\$1,085,014	\$1,429,613	\$460,404	\$266,808

(a) The consultancy fee arose from services provided by Mr A to Company B.

(b) The rental income arose from rent paid by Company H (another service company of Mr A) in respect of the occupation of Property 3.

19. The Taxpayer earned no consultancy fees for the years 1994 and 1995. Consultancy fees were however earned by Company H in the sums of \$1,504,006 for 1994 and \$915,586 for 1995.

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20. The issue before us is whether the Taxpayer is liable for profits tax arising from the gains it obtained through its dealings with Property 2. It was conceded at the hearing that the Taxpayer is liable for profits tax in respect of the gains it made from sale of the two car parks.

The sworn evidence of Mr A

21. All the shares of the Taxpayer were held between Mr A and his wife in the ratio of 99:1. Both of them were directors of the Taxpayer. Mr A made all the decisions.

22. Property 1 was 980 square feet in area. The Quarters were smaller with 600 square feet. It was available to Mrs A at a monthly rent of \$500. Property 1 was sold when the Quarters were available as a matter of certainty.

23. After obtaining the UK right of abode in November 1992, the future of the family was more secured. It was felt that the family would spend a long time in Hong Kong.

24. Mrs A received notice from the Government in the beginning of 1993 indicating that the Quarters were earmarked for redevelopment and she and her family were required to vacate the same.

25. He was unsure as to the chance of success in relation to his fourth application for visa to Country C.

26. He was in charge of sale of units in District F. Property 2 was the only unit left. It was offered to him on favourable terms.

27. Country C's visa granted on 28 June 1993 was valid for a period of 6 months. The interests of his son prompted him to take advantage of the visa and landed in Country C in February 1994. He tried but failed to obtain a job in Country C. He therefore returned to Hong Kong and stayed in Property 3 with his mother. Property 3 is about 700 square feet in area with two bedrooms. He resumed working with Company B. He did not tender his resignation prior to his departure for Country C.

Our decision

28. We have to ascertain the Taxpayer's intention as at 26 March 1993. We have to determine whether the Taxpayer had a settled intention to acquire Property 2 as a long term investment for use by its directors as their residence. This is closely tied to the question whether Mr and Mrs A had decided by that stage that their future was in Hong Kong.

29. The Taxpayer's case rests on two principal planks:

- (a) A settled intention to remain in Hong Kong after obtaining the right of abode in November 1992 and

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(b) A need to cater for withdrawal of the accommodation in the Quarter.

30. The grant of the right of abode in November 1992 is a pointer in favour of the Taxpayer. It is however doubtful whether on the totality of the evidence the long termed goal of Mr and Mrs A was to have the whole family stationed in Hong Kong. By May 1992, Mr and Mrs A had 3 failed applications to Country C. They persisted and made their fourth attempts by application in Country E in July 1992. They did not abandon this application after obtaining the right of abode. Mr A was notified of the 19 April 1993 interview on 11 February 1993. Property 2 was purchased on 26 March 1993. He went for the interview in Country E on 19 April 1993. There can of course be no assurance for success bearing in mind the 3 failed attempts. His persistent quest for Country C's visa does however cast doubts on his alleged adherence to Hong Kong after obtaining the right of abode in November 1992.

31. The enforced move from the Quarters figured little in pre-hearing correspondence between the Taxpayer and the Revenue. There is force in the Revenue's contention that this is a belated attempt to patch up the Taxpayer's case. The 30 November 1993 letter from the government authority required vacation on or before 1 March 1995.

32. The consultancy fees earned by the Taxpayer at the material times exceeded \$100,000 per month. There would have been no difficulty for the Taxpayer to pay the monthly instalments of over \$50,000 per month under the 26 March 1993 agreement for the period between 1 January 1994 to 31 December 1994. There is however no evidence as to the savings of Mr and Mrs A. It is not clear how the balance of the purchase price of \$4,268,978 due on 1 January 1995 would be financed by the Taxpayer. Property 2 was sold on 24 December 1993 before that sum fell due. Given the level of consultancy fees earned by the Taxpayer and Company H, we are not convinced by the Revenue's argument that the Taxpayer did not have the financial capacity to hold Property 2 on a long term basis.

33. The Taxpayer placed considerable emphasis on the fact that it did not have a previous history of property dealings. Property 1 and Property 3 were used as the residence of its directors. The two car parks were the only tradings conceded. There is also no evidence of properties dealings by Mr and Mrs A in their personal capacities.

34. We find this case difficult and the arguments finely balanced. Two matters turned the scale against the Taxpayer. First, Mr A laid considerable emphasis in the course of his evidence on certainty. The position as at 26 March 1993 was one of uncertainty. The future of the family was unclear. It was unlikely for the Taxpayer to make any arrangement on a long term basis. Secondly, the opportunity to purchase was purely fortuitous. The acquisition was not the result of any careful planning.

35. For these reasons, we dismiss the Taxpayer's appeal.

36. We are indebted to all parties for their careful submissions.

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