

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D69/96

Profits tax – whether profit derived from sale of a property assessable to profits tax.

Panel: Robert Wei Wen Nam QC (chairman), John Peter Victor Challen and Sydney Leong Siu Wing.

Dates of hearing: 18, 24 July and 21 August 1996.

Date of decision: 22 November 1996.

The 2nd taxpayer was the former wife of the 1st taxpayer. In March 1993, they purchased the subject flat which they sold some four months later at a profit. At the hearing, the 1st taxpayer gave evidence and called two witnesses. The Board found that the 1st taxpayer's intention in acquiring the subject flat was to hold it as a long-term investment for the purpose of using it as a home for his father and himself, but his long-term investment plan was frustrated mainly by his father's death, which made it impossible to achieve the purpose of providing a home for his father and himself.

Held:

The purchase and sale of the subject flat did not amount to an adventure in the nature of trade, and the profit on sale is not subject to profits tax.

Appeal allowed.

Cases referred to:

Simmons v CIR 53 TC 461
All Best Wishes Ltd v CIR 3 HKTC 750
Cunliffe v Goodman [1950] 2 KB 237
D16/91, IRBRD, vol 6, 24

Yim Kwok Cheong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

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Nature of appeal

1. This is an appeal by an individual (the 1st Taxpayer) and his former wife (the 2nd Taxpayer) against the profits tax assessment raised against them for the year of assessment 1993/94 for assessable profits of \$420,000 with tax payable thereon of \$63,000. The Taxpayers claim that the profit on the disposal of a property (the Subject Flat) is capital gain and is not assessable to profits tax.

Determination of the Commissioner

2. The assessment in question was confirmed by the determination of the Commissioner of Inland Revenue dated 16 October 1995 which contains the following statement of facts which is not in dispute (subject to the Note in paragraph 2.4 below).

2.1 The Taxpayers were husband and wife. They divorced on 27 January 1993.

2.2 On 13 March 1993, the Taxpayers agreed to purchase the Subject Flat at a price of \$2,200,000. The assignment for the purchase was executed on 10 May 1993. The purchase of the Subject Flat was financed by a mortgage loan of \$1,450,000 obtained from Company A (a credit limited), repayable at \$12,128.40 per month.

2.3 By an agreement dated 20 July 1993, the Taxpayers sold the Subject Flat for a consideration of \$2,800,000.

2.4 At all relevant times, the 1st Taxpayer resided at a rented property at a flat (the Rented Flat) at a monthly rental of \$7,500. The lease covered a period from 15 January 1992 to 14 January 1994. (Note. The 1st Taxpayer claims that the lease was terminated on 15 May 1993; see paragraph 3.1 below.)

2.5 The assessor was of the view that the purchase and sale of the Subject Flat amounted to an adventure in the nature of trade and issued to the Taxpayers a profits tax return for the year of assessment 1993/94 for completion. The Taxpayers failed to file the return within the stipulated period. On 21 March 1995, the assessor raised on the Taxpayers the following profits tax assessment for the year of assessment 1993/94:

Estimated Assessable Profits	\$420,000
Tax payable thereon	\$63,000

2.6 The 1st Taxpayer on behalf of the Taxpayers objected against the profits tax assessment for the year of assessment 1993/94 in the following terms:

‘I purchased the Subject Flat for my residential use with my father [XXX]. I requested my ex-wife [XXX] to sign on the assignment as a joint owner in

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order to obtain a mortgage loan from the bank. I could not obtain a mortgage loan in my sole name because I did not possess any documentary evidence to prove my income. All the downpayment and expenses for the Subject Flat were borne by myself and my father ... Why I have to sell the Subject Flat within a few months? It was because at that time my father was sick. He eventually passed away. At that time, I felt very bad. I also had financial problems. I even had to borrow from my friends to pay for the funeral expenses. Therefore I had to sell the Subject Flat. Part of the sale proceeds was used to repay my friends. The balance was later used to purchase another flat (the New Flat).'

The 1st Taxpayer attached to his notice of objection a copy of death certificate showing his father passed away on 29 April 1993.

2.7 The New Flat was purchased by the 1st Taxpayer in joint names with his brother on 6 September 1994.

Notice of appeal

3. By a notice of appeal dated 23 October 1995 and filed on behalf of the Taxpayers, the 1st Taxpayer made a number of statements which are principally as follows:

3.1 'I gave a notice to the landlord for the termination of the lease [of the Rented Flat] immediately after the purchase of the Subject Flat (on 5 March 1993). The landlord initially refused to terminate the lease since its term had not yet expired, but later showed his understanding on hearing my explanation that the request for termination simply resulted from my acquisition of another unit in the same housing estate, that is, the Subject Flat. At his request, I rented the flat for another two months until 15 May 1993, and the rent was offset against the two-month deposit that was paid on the signing of the tenancy agreement. The lease was formally terminated on 15 May 1993. As far as I know, the landlord sold the Rented Flat in the form of vacant possession several months after the termination of the lease.'

3.2 'My father underwent a major operation prior to February 1993. His doctor, who performed the operation, said that it was quite a success and he would soon be discharged from hospital. Therefore, in early March 1993, I bought the Subject Flat so that I could live with my father. However, after the acquisition of the Subject Flat through the estate agent on 5 March 1993 and the subsequent payment of the additional deposit in the solicitor's office on 12 March 1993, my father's condition deteriorated unexpectedly. On 29 April 1993 he passed away. While I was grieving over his death, I made the arrangement for his funeral and completed the transaction. Under these circumstances, I did contemplate calling off the transaction, but eventually went through it on my friend's advice as I would be bound to suffer a considerable loss if I failed to complete the transaction or terminated it

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unilaterally. For not only did I have to pay the damages, the deposit of some \$200,000 and agent commission already paid and the outstanding legal fees totalling some several hundred thousand dollars would go down the drain. With a heavy heart, I completed the transaction in face of this disadvantage, and the formal transaction date was 7 May 1993.'

3.3 'I encountered financial and economic difficulties after the completion of the transaction. The downpayment of the said property and the relevant expenses for my father's funeral had all been beyond my own anticipation. I borrowed money from friends to pay for the funeral expenses, and asked my ex-wife to sign the deeds as my guarantor to secure a mortgage loan from Company A on the property (that is, the Subject Flat). The following are the reasons for the sale of the said property within a short period of time:

- (1) To repay the debts that I owed to my friends with some of the proceeds from the sale of the property.
- (2) My ex-wife's boyfriend did not take kindly to my asking her to sign and act as my guarantor for the property. To avoid misunderstanding, I sold the property as quickly as I could.
- (3) Most importantly, it seemed meaningless to move in the Subject Flat after the death of my father. My original plan upon the purchase of the property was that one of the bedrooms would be rented out to relieve me of the burden of repaying the mortgage loan. But with the death of my father, I abandoned the plan and proceeded to sell the property.
- (4) The balance of the proceeds from the sale was used to finance the payment for the New Flat that I later bought for self occupation.'

3.4 'These are the reasons for the sale of the said property within a short period of time, and I had no intention to engage in property speculation.'

Parties and the hearing

4. The hearing of this appeal commenced on 18 July 1996, continued on 24 July 1996 and was concluded on 21 August 1996. The 1st Taxpayer appeared on behalf of himself and the 2nd Taxpayer who was absent. Mr Yim, assessor, appeared as the representative of the Commissioner of Inland Revenue. The 1st Taxpayer and a Mr S gave evidence for the Taxpayers. No other witness was called.

The 1st Taxpayer's evidence in chief

5. The 1st Taxpayer's evidence in chief consists partly of oral testimony and partly of written statements treated by agreement as part of his evidence in chief.

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6. In his oral testimony, the 1st Taxpayer stated that his parents had five children including himself. His parents jointly owned \$600,000 in fixed deposit plus some shares. The downpayment for the Subject Flat was paid by the 1st Taxpayer. He planned to live with his father at the Subject Flat, and his father would be contributing \$3,000 per month. They had a family meeting on the matter when he was purchasing the Subject Flat. The arrangement was with the agreement of his parents. Furthermore, a friend also promised to rent a room at the Subject Flat from the 1st Taxpayer. His father was in the catering business. The 1st Taxpayer was a tourist coach driver. His ex-wife (the 2nd Taxpayer) was earning about \$15,000 per month. At that time one must earn \$20,000 per month before one could get a bank loan. That was why he asked his ex-wife to join in. His employer only reported his basic salary of \$3,000 to \$4,000 per month. But he also had tips from the tourists, and he sold souvenirs to them on the bus and there were commissions from the shops to which he took the tourists. That was the norm of this profession. So in fact his actual total salary was about \$10,000.

7. The hearing on 18 July 1996 then adjourned to enable translations to be made of a written statement and a bundle of documents produced by the 1st Taxpayer. At the adjourned hearing on 24 July 1996, the translations were made available by the Revenue. With the agreement of Mr Yim, the 1st Taxpayer's written statement produced at the previous hearing and his statements contained in the notice of appeal (see paragraphs 3.1 to 3.4 above) were treated as part of his evidence in chief.

8. The 1st Taxpayer's written statement was mainly as follows:

8.1 'I and my ex-wife had formally divorced in January 1993. Then why we would purchase the Subject Flat jointly on 5 March 1993. Here I have to say again that when I purchased the Subject Flat, since I did not have the sufficient income proof, I was unable to obtain a loan from the bank in respect of the property. As I was caught in a dilemma, I had no alternative but to ask my ex-wife to help me by signing on the title deed of the above property as a guarantor. Only after that could I obtain a loan from Company A. However, the downpayment and all expenses in respect of the above property were paid by me. Therefore, all liabilities in respect of the above property had nothing to do with my ex-wife.'

8.2 'Regarding why I was confident that I could afford the instalments of the property when my monthly income was \$10,000 only, since before I purchased the property, my best friend Mr S had promised me he would rent another half of the property at \$4,000 for self-residence. Previously Mr S had also rented the Rented Flat with me jointly at \$4,000. My father also agreed to give me \$3,000 each month to alleviate my burden on paying the instalments of the property. Therefore, I had thought very clearly when I purchased the property that I had sufficient source of income to finance the instalments of the property before I made the purchase.'

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- 8.3 'I had rented the Rented Flat jointly with Mr S on 15 January 1992 where Mr S had shared half of the rent of the above property. In early March 1993 when I purchased the Subject Flat, I formally asked the landlord for the termination of the tenancy agreement in respect of the Rented Flat. Later, the landlord and I agreed that the tenancy agreement should be terminated formally on 15 May 1993. Mr S could act as a witness on this point. Moreover, I had learned later that the Rented Flat was sold by delivery of vacant possession on 21 May 1993.'
- 8.4 'I paid the initial deposit on 5 March 1993 and paid the additional deposit on 13 March 1993. However, my father's condition had deteriorated quickly and died on 29 April 1993. In facing such sudden unfortunate incident, I had thought of cancelling the transaction of the above property (the Subject Property). Later, my friend advised me that if I cancelled the transaction of the above property unilaterally, I would suffer a great loss. I was again put in a dilemma. Therefore, I could only continue to complete the transaction of the property with a heavy heart.'
- 8.5 'Since I had spent all my money on the downpayment and legal fee of the above property, I had to borrow money from my best friend Mr S to finance the funeral arrangements of my father. Owing to the sudden death of my father, I was in acute financial difficulty. Therefore, I had to sell the property within a very short period of time.'
- 8.6 'The proceeds derived from the sale of the Subject Flat was about \$1,170,000, that is, the downpayment of \$750,000 made when purchasing the Subject Flat plus \$420,000 for the IRD.

Regarding the amount of \$1,170,000, I had to repay \$50,000 to Mr S. Besides, I had utilised about \$915,000 for the purchase of the New Flat, including downpayment of \$780,000, decoration expenses of \$100,000, legal fee of \$35,000 and stamp duty...'

1st Taxpayer's evidence in cross-examination

9. The 1st Taxpayer's evidence in cross-examination may be summarised as follows:
- 9.1 The 1st Taxpayer's father retired from work in about 1991.
- 9.2 As to the joint deposit of his parents, it was actually AUD100,000, somewhat less than HK\$600,000.
- 9.3 He has three sisters. The elder sister is blind and has disabled person's allowance to meet her living expenses.

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9.4 As to his parents' interest income from the joint AUD deposit, the highest interest rate for AUD was over 10%. It was about 9% at the time when he bought the Subject Flat.

9.5 Living expenses of both his parents were about \$4,000 per month.

9.6 As for shares, his parents had about 1,600 shares of Bank B. It would have been \$70 per share in 1992/93, but he did not really know.

9.7 His youngest sister would give \$1,000 to \$1,500 per month to his mother, regularly. She was a clerk, earning about \$8,500 per month in late 1992.

9.8 The other younger sister emigrated to an overseas country a long time ago.

9.9 As to the salaries reported in the employer's returns for the years of assessment 1991/92, 1992/93 and 1993/94, namely, \$35,830, \$42,470 and \$51,500 respectively, the employer only reported his basic salary. They did not report tips and commissions which totalled \$7,000 to \$8,000 per month in late 1992.

9.10 As for tips, tourists touring around Hong Kong only would pay \$20 per head per day. Those going to China or Macau did not pay. The coach had a capacity of 42 persons; average load was 25 persons. He did six to seven four-day tours each month. The tourists would go to China or Macau for one or two days, during which time he could do other tours. Shops gave him laiseses at the rate of \$40 to \$50 per visit. He would bring a group to five or six shops in one day. They sold souvenirs to each group once only. He would get about \$150 a day from souvenir sales.

9.11 The coach company had arrangements in place to give the drivers a stable income each month. Tips and commissions amounted to \$7,000 to \$8,000 per month. Total income including basic salary would be over \$10,000 per month. The company would tell the driver on his first day that his income would be about \$10,000 per month. The newspaper advertisement also said so. He saw it in the Oriental Daily News. He did not keep a copy.

9.12 Immediately before the purchase of the Subject Flat, the 1st Taxpayer had about \$900,000 cash, being proceeds of sale of another property which he owned. It was on mortgage with monthly instalments at \$9,000. He had sold it for \$1,430,000. The balance after repaying mortgage loan was his own money. The property had been in the joint names of his ex-wife and himself. He had bought the flat to patch up his marriage with his ex-wife but the attempt failed. He lived in the flat once. She did not put in any money. The mortgage loan was based on the income of his ex-wife. She was a stewardess. The credit limited was Company A.

9.13 Out of the \$900,000 in his bank account, he spent a total of \$860,000 to \$870,000 in acquiring the Subject Flat. Monthly repayment was \$12,128. He had the ability to pay the instalments. Mr S promised to rent a room at \$4,000 per month. No one

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would take the risk if he could not repay the mortgage loan. His income was almost the same during the past several years; no change between the time he was buying the Subject Flat and the time he was buying the New Flat.

9.14 Mr S was able to apply for his wife to come to Hong Kong. That was in about October 1993. They moved to a property developed under the Home Ownership Scheme (the S Property). Mr S lived there with his family.

9.15 With regard to the 2nd sentence in paragraph 3.3 above of his notice of appeal, the downpayment was within his anticipation. He had the ability to pay that, but his father's funeral expenses were unexpected.

9.16 With regard to paragraph 3.3(2) above of his notice of appeal, the purpose in getting his ex-wife to act as a guarantor was to get the loan from the bank. She used her income proof for the loan application. The bank did not know they were divorced. His ex-wife joined in as a co-owner. Her name appeared in the purchase agreement.

9.17 His parents had been residing in a public housing estate unit since around 1989. The registered tenant of the unit was his mother. She was still alive. The other registered occupants of the unit were himself, his brother and three sisters. All the seven of them were registered. At the relevant time, his parents and his blind sister were residing in the unit. Another sister had emigrated. The 3rd sister was married and at the relevant time lived elsewhere. At that time the 1st Taxpayer resided in the Rented Flat. Before that he had lived in a flat in District C (the C Flat).

9.18 The arrangement was that his father was to move into the Subject Flat to live with the 1st Taxpayer. The Housing Authority was not informed about his father moving out. Even when his brother and sisters were moving out, they did not notify the Housing Authority of it. Had they done so, probably the unit would have been taken back by the Housing Authority.

9.19 Before he acquired the Subject Flat, he had lived in the Rented Flat. The two flats had the same area of 639 square feet. Each had two rooms and one toilet. In the Subject Flat, he would have had to share one room with his father while renting out the other room.

9.20 According to the doctor's comments, his father was going to recover.

9.21 It would not have been better for his father to go back to the public housing estate unit to be looked after by his mother. She was very old and had to take care of his blind sister. His father needed care and assistance during the night. One of the purposes in acquiring the Subject Flat was for his father to come and live with him. From the sale of the C Flat, he had received a sum of money. Living in the Rented Flat was not long-term planning. Therefore he decided to use the money to purchase the Subject Flat for his father to live with him.

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9.22 In the daytime his father could move around by himself. After the operation he had to carry a urine bag which was good for a whole day's use. At night he needed the 1st Taxpayer's assistance in changing the bag. It was difficult for him to change it by himself because the bag was attached to his abdomen.

9.23 After selling the C Flat, he lived in the Rented Flat. He did not buy a flat because he had not seen one he liked. There was a lapse of one year and two months between renting the Rented Flat and buying the Subject Flat. When he rented the Rented Flat, his father was still in good health. Later, he went back to live with his mother in the public housing estate unit.

9.24 If he bought a property, it was for a long term. For example, he bought the New Flat, and he has been living there for more than two years. When he bought the Subject Flat, it was also for a long-term purpose. It was the dramatic change in his family which made him decide to sell it. The New Flat was bought one year after selling the Subject Flat. He felt upset about his father's death. When he sold the Subject Flat, he was not in the mood for buying property.

9.25 He had acquired the Subject Flat to replace the Rented Flat. Rent for the Rented Flat was \$7,500. Mortgage on the Subject Flat was \$1,450,000, and monthly repayment was about \$12,000.

9.26 The main reason for him to buy the Subject Flat was for him to live with his father. Upon his death, it became meaningless to move into the Subject Flat. He also had some difficulty with the funeral expenses. So he decided to sell the Subject Flat.

9.27 As for funeral expenses, \$43,000 was accounted for by documents on the Taxpayer's bundle. Laises and the money paid to those people helping the funeral are not documented. He paid for the funeral expenses. He borrowed \$50,000 from Mr S, which was mainly spent on the funeral. He did not ask his mother for financial assistance. Financially, he was the best of all the children. So he did not tell his mother about his difficulties.

9.28 His mother could not change the bag for his father; she did not have the strength. She could not cope with his weight.

Mr S

10. The next witness was Mr S. The Taxpayers' bundle contained a document dated 17 July 1996 and written and signed by Mr S. Earlier on in the proceedings, Mr Yim had accepted the statement subject to reservations with respect to certain portions. Now Mr Yim waived his reservations and accepted the whole statement and would confine his cross-examination to matters not mentioned in the statement.

Mr S's evidence in chief

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11. The examination in chief was conducted by the chairman of the Board for the 1st Taxpayer. Mr S formally put in the written statement and confirmed the truth of its contents. The statement reads as follows:

‘Clerk to the Board of Review

Dear Sir,

This is to certify that I, [XXX], Identity Card No [XXX], have rented the Rented Flat together with the 1st Taxpayer from 15 January 1992 to 15 January 1993.

The 1st Taxpayer purchased the Subject Flat in early March 1993. In March 1993, he negotiated with the agent for the then landlord of the Rented Flat about the termination of the tenancy agreement of the Rented Flat. The tenancy agreement was terminated officially on 15 May of the same year.

At the same time, I started to rent one of the rooms at the Subject Flat which the 1st Taxpayer had purchased. We had agreed on a rent of \$4,000. Later, because of the death of the 1st Taxpayer’s father and due to the 1st Taxpayer’s personal reasons, the above property was sold and the abovementioned tenancy agreement was terminated.

After his father’s death, the 1st Taxpayer needed money to take care of his father’s funeral arrangements, therefore, he borrowed \$50,000 from me. He repaid all the money to me later on in early August.

(Sgd)

Date (Illegible) July 1996’

Mr S’s evidence in cross-examination

12. He was the owner of the S Property, his then residence. It was bought in 1985 for about \$142,000 under the Home Ownership Scheme. He knew that the property should be occupied by the owner himself, but he did not know the effective period for such restriction. His parents had many children, so his brother(s) and sister(s) lived either in the S Property or a public housing estate. His parents had given him the money to buy the unit (the S Property) and his name was registered as the owner. His mother owned the unit in the public housing estate. In November 1993, his wife came to Hong Kong from mainland China. At the end of 1993, his mother moved back to the public housing estate. At the beginning of 1994, he removed to the S Property. He still lived there.

13. In January 1992, he rented a room from the 1st Taxpayer. At about the beginning of 1992 his wife told him that she could come to Hong Kong. So he planned to rent a room from the 1st Taxpayer on a long-term basis. She was applying to come to Hong

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Kong. The application took a long-time. About July or August 1993, his wife got a formal notice that she was permitted to come to Hong Kong permanently. They were married at the beginning of 1990 in China.

Statement of the 1st Taxpayer's elder brother

14. The Taxpayer's bundle contained a statement dated 17 July 1996 and signed by the 1st Taxpayer's elder brother. Mr Yim accepted the truth of the statement which reads as follows:

'Members of the Board of Review

Dear Sir,

I refer to the mortgage and expenses incurred by the New Flat which my younger brother [the 1st Taxpayer] purchased in early July 1994.

- (1) The 1st Taxpayer had no proof of income at that time.
- (2) For this reason, when the mortgage was obtained from the bank, my name was added to the contract, because I had a stable occupation and a proof of income.
- (3) However, I have not paid any of the expenses or instalments for the above flat.
- (4) I hereby certify that this flat is solely owned by my younger brother. I have not incurred any actual expenses in respect of the flat.

_____(Sgd)____'

The law

15. The relevant legal principles may be stated as follows.

15.1 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 acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? It is not possible for an asset to be both trading stock and permanent investment at the same time, nor to possess an indeterminate status – neither trading stock nor permanent asset (per Lord Wilberforce in Simmons v CIR 53 TC 461 at 491).

15.2 On the question of intention, Mortimer J stated in All Best Wishes Ltd v CIR 3 HKTC 750 at 771:

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'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 single 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...'

15.3 Asquith LJ in Cunliffe v Goodman [1950] 2 KB 237 at 253 had this to say about the word 'intention':

'... If there is a sufficiently formidable succession of fences to be surmounted before the result at which X aims can be achieved, it may well be unmeaning to say that X "intended" that result.'

15.4 In D16/91, IRBRD, vol 6, 24 at page 31, the Board stated:

'... this element of reasonable expectation of an ability to carry out one's intention is an essential ingredient of the intention; without it one can have no true intention, but only a wish, a hope; in any event, such a bare assertion of intention normally lacks credibility...'

15.5 Frustration of a plan for investment, which compels realisation, even if foreseen as a possibility, surely cannot give rise to an intention to trade (per Lord Wilberforce in Simmons v CIR at 494).

Findings

16. Both the 1st Taxpayer and Mr S gave their evidence in a straightforward manner. Neither of them appeared to be holding anything back. We find them both to be credible witnesses and accept their evidence as summarised above and also their written statements. From their evidence and the documents produced by the two sides, we find as follows.

16.1 The 1st Taxpayer resided in the Rented Flat which he rented under a two-year tenancy from 15 January 1992 to 14 January 1994 at \$7,500 per month. He sublet one room to Mr S for which Mr S paid him a rent of \$4,000 per month.

16.2 The 1st Taxpayer's parents were residing in the public housing estate unit together with his blind sister.

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16.3 His father was ill with cancer in the bladder. Sometime prior to February 1993, he underwent a major operation in hospital. The doctor who performed the operation stated that it was quite a success and that he would soon be discharged from hospital.

16.4 As a result of the operation, his father had to carry a urine bag. At night he needed assistance when he changed the bag. His mother could not cope because of his father's weight.

16.5 Acting in reliance upon the doctor's views mentioned above, the 1st Taxpayer set about making plans for acquiring a flat for the purpose of using it as a residence for his father and himself on a long-time basis.

16.6 There was a family meeting. His parents agreed to an arrangement whereby his father would come and live with him in the Subject Flat he was purchasing and would pay him \$3,000 per month as a contribution towards the 1st Taxpayer's outgoings. Furthermore, Mr S agreed to rent a room at the Subject Flat at \$4,000 per month. With the addition of his own monthly income of \$10,000 as a tourist coach driver, he concluded, after careful consideration, that he would have sufficient sources of income to meet his outgoings, including the mortgage loan repayments.

16.7 An initial deposit was paid for the Subject Flat on 5 March 1993, and was followed by a further deposit paid on 12 March 1993. An agreement for the purchase of the Subject Flat at a price of \$2,200,000 was entered into on 13 March 1993.

16.8 The further deposit was paid and the purchase agreement was entered into in the names of the Taxpayers as purchasers. They had been husband and wife until they divorced on 27 January 1993. At the request of the 1st Taxpayer, his ex-wife, the 2nd Taxpayer, lent her name to the purchase to enable the 1st Taxpayer to obtain a mortgage loan of \$1,450,000 (repayable by 240 monthly instalments of \$12,128.40 each) to finance the purchase. Before the grant of a loan, the bank required proof of income. The 1st Taxpayer was unable to produce sufficient proof of his income, but the 2nd Taxpayer, a stewardess, could prove hers. Hence she was asked to assist. In fact, she had rendered similar assistance in respect of the 1st Taxpayer's purchase of another property (see paragraph 9.12 above).

16.9 In the meantime, the 1st Taxpayer had notified the landlord of the Rented Flat of his desire to have an early termination of the tenancy agreement in view of his purchase of the Subject Flat, and had been able to get the landlord to agree to have the tenancy agreement terminated in two months' time, that is, on 15 May 1993. In fact it was terminated on that day.

16.10 Sometime after 13 March 1993, the 1st Taxpayer's father's condition deteriorated unexpectedly. On 29 April 1993, he passed away.

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16.11 Upon his father's death, the 1st Taxpayer contemplated calling off the purchase of the Subject Flat. His friend advised him that he would suffer a considerable loss if he failed to complete, because not only would he have to pay damages, but the deposit of some \$200,000, agent's commission and legal fees totalling several hundred thousand dollars would be lost as well. Taking his friend's advice, he completed the purchase on 10 May 1993 when an assignment was executed.

16.12 On 20 July 1993, the 1st Taxpayer sold the Subject Flat for \$2,800,000. There were three reasons for the sale.

- (a) To repay the debt of \$50,000 to his friend Mr S out of the proceeds of sale. The debt had been incurred to pay for the funeral expenses which had been unexpected.
- (b) His ex-wife's boy friend was not happy about her signing and acting as 'guarantor' for the Subject Flat. To avoid a misunderstanding, he sold the Subject Flat.
- (c) Most importantly, it was meaningless to move into the Subject Flat after the death of his father. So he abandoned his plan for letting one room to Mr S and sold the Subject Flat.

Conclusions

17. Applying the relevant legal principles to the facts and findings set out above, we have arrived at the following conclusions.

17.1 The 1st Taxpayer's intention in acquiring the Subject Flat was to hold it as a long-term investment for the purpose of using it as a home for his father and himself. The intention was realistic and realisable because the doctor's views and the financial arrangements gave the 1st Taxpayer a reasonable expectation that the long-term plan would be successfully carried out. The doctor had led him to expect his father to recover (see paragraphs 9.20 and 16.3 above). As for financial arrangements, the \$3,000 monthly contribution from his father and the \$4,000 monthly rent from Mr S, plus his monthly income of \$10,000 as a tourist coach driver, would bring in a total income of \$17,000 per month. After careful consideration, the 1st Taxpayer had concluded that it was sufficient to meet all the outgoings including the mortgage loan repayments.

17.2 Mr Yim submitted that the 1st Taxpayer's parents did not appear to have the means to pay the \$3,000 monthly contribution. We are unable to agree. They had a fixed deposit in Australian dollars equivalent to about HK\$600,000. At 9% (the rate for Australian dollars at the time of the acquisition) (see paragraph 9.4 above), the deposit should produce an interest income of \$4,500 per month. There was also the regular contribution of \$1,000 to \$1,500 per month from his youngest sister who was a clerk and lived with her husband elsewhere (see paragraph 9.7 and 9.17 above). So the parents had a total income of \$5,500 to \$6,000 per month. After deducting \$3,000 per month his father

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was going to pay to the 1st Taxpayer, his mother should have \$2,500 to \$3,000 per month for living expenses, and that compares with the living expenses of \$4,000 per month for both parents (see paragraph 9.5 above). As for the 1st Taxpayer's income of \$10,000 as a tourist coach driver, Mr Yim submitted that tips and commissions were not stable sources of income that the 1st Taxpayer could rely on to meet the monthly mortgage repayments. On the other hand, the 1st Taxpayer maintained that his income was at all times for the past several years around \$10,000 per month and that in fact the employer had arrangements in place to give the drivers a stable income (see paragraph 9.11 above). We accept the 1st Taxpayer's evidence that he had sufficient sources of income to meet all his outgoings including the mortgage loan instalments.

17.3 The 1st Taxpayer's plan for a long-term investment for the purpose of providing a home for his father and himself was frustrated by (1) the unexpected deterioration of his father's condition and his subsequent death, (2) the need to repay the \$50,000 debt incurred to pay for the funeral expenses and (3) the desire to avoid a misunderstanding with the 2nd Taxpayer's boy friend over her assistance in obtaining the mortgage loan. The main cause of the frustration, and the main reason for the sale, was the fact that, by reason of the father's death, the purpose of providing a home for him and the 1st Taxpayer on a long-term basis could no longer be achieved.

17.4 Mr Yim argued that, in view of her boy friend's discontent, the 2nd Taxpayer's acting as 'guarantor for the property' (see reason (b), paragraph 16.12 above) was not a feasible or viable long-term arrangement. We cannot agree. The word 'guarantor', was probably a misnomer for the word 'mortgagors', because purchasers normally assume liability as mortgagors rather than guarantors. Be that as it may, she was a party to a long-term (20-year) arrangement and was bound by her obligations arising thereunder until the loan was fully repaid. The arrangement was in place and operative although between the 1st and 2nd Taxpayers there was an understanding that she was merely lending her name to help the 1st Taxpayer to obtain the mortgage loan. There was no question of the 2nd Taxpayer's obligations towards the bank being otherwise than feasible and viable long-term obligations. In the event, her obligations were discharged by the repayment of the loan upon the sale of the Subject Flat which was a direct consequence of the frustration of the long-term investment plan.

17.5 Mr Yim submitted that there was no need for the 1st Taxpayer to acquire the Subject Flat as it had the same area as the Rented Flat. The answer to that is that the Rented Flat was rented for only two years and had only ten months to run before the expiration of the tenancy agreement, while the 1st Taxpayer was planning a long-term investment to set up a permanent home for his father and himself.

17.6 It should be mentioned that Mr Yim, in cross-examining the 1st Taxpayer and Mr S, touched on absenteeism from a public housing estate unit in the one case (see paragraph 9.17-18 above), and from a Home Ownership Scheme unit in the other (see paragraphs 12 and 13 above). However, the matter was not fully explored, nor was any issue, legal or factual, raised against the Taxpayers. There was therefore no need to consider the matter any further.

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Decision

18. For all the above reasons, this appeal succeeds, and the profits tax assessment under appeal is hereby annulled.