

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D106/99

Profits Tax – sale of property – whether profits derived from the sale of the property assessable to profits tax – intention at the time of acquisition – whether the taxpayer is necessary to show a pressing need to purchase or to sell – section 14 of the Inland Revenue Ordinance.

Panel: Audrey Eu Yuet Mee SC (chairman), Herbert Tsoi Hak Kong and Mary Teresa Wong Tak Lan.

Dates of hearing: 30 August and 30 December 1999.

Date of decision: 11 January 2000.

The taxpayer was an engineer working for Company A. The taxpayer was living with his sisters in quarters provided by his employer. By a provisional agreement dated 26 August 1995, the taxpayer acquired the Subject Property. The Subject Property was an uncompleted property, which he bought off the plans. The taxpayer completed the purchase on 6 June 1996. By a provisional agreement dated 26 October 1996, the taxpayer sold the Subject Property and completed the sale on 10 December 1996.

The assessor raised tax on the gain. The taxpayer objected to the assessment on the ground that the Subject Property was intended as his own residence and was not purchased in the nature of trade. The Commissioner upheld the assessment and the taxpayer appealed.

Held:

- (1) Whether a person is carrying on a trade in buying and selling a property depends on his intention at the time of the acquisition : was it acquired with the intention of disposing it at a profit, or was it acquired as a permanent investment. The person's stated intention must be tested against the whole of the evidence. We remind ourselves that the onus of proof is on the taxpayer to persuade us that the assessment is incorrect and that a single transaction can amount to an adventure in the nature of trade.
- (2) The taxpayer gave evidence as its only witness. Having considered all the evidence, the Board satisfied that based on his earnings, the taxpayer was financially capable of holding the Subject Property long term and it was reasonable for the taxpayer to wish to acquire his own property even if he had the luxury of his free quarters. It was not necessary for the taxpayer to persuade the Board that there was a pressing need to

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purchase or to sell. The Board found the taxpayer to be a credible witness and the Subject Property was purchased by the taxpayer for use as the residence of his sister and himself.

Appeal allowed.

Ngan Man Kuen for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The appeal

1. The Taxpayer appeals against the determination of the Commissioner of Inland Revenue dated 21 April 1999 in respect of his profits tax assessment for the year of assessment 1996/97. He claims that the gains arising from the disposal of the Subject Property should not be subject to profits tax.

The background

2. The following background facts are not in dispute.

3. At all material times, the Taxpayer was an engineer working for Company A. He was living with his sister in quarters provided by his employer at District B.

4. By a provisional agreement dated 26 August 1995, the Taxpayer acquired the Subject Property at District C at a consideration of \$4,456,000. It was an uncompleted property which he bought off the plans.

5. The occupation permit of the Subject Property was issued on 31 January 1996. The Taxpayer completed the purchase on 6 June 1996 with the help of a mortgage from Company D, a finance company.

6. By a provisional agreement dated 26 October 1996, the Taxpayer sold the Subject Property for \$6,880,000 and completed the sale on 10 December 1996. The disposal gave rise to a gain of \$1,691,731.

7. The assessor raised tax on the gain. The Taxpayer objected to the assessment on the ground that the Subject Property was intended as his own residence and was not purchased in the nature of trade.

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The determination

8. The Commissioner of Inland Revenue upheld the assessment after taking into account several factors. First the Subject Property was sold within 5 months after completion and about 2 months after decoration. In addition it was left vacant before sale. Secondly, the Taxpayer has been provided with quarters from the employer since 1987. There was no urgent need for the Taxpayer to purchase his own residence. After the sale, the Taxpayer did not acquire any property in replacement. Thirdly the Taxpayer claimed that he sold the Subject Property because it was far from his place of work. But this should have been known to him prior to the purchase. Fourthly, there was doubt whether the Taxpayer was financially capable of holding the Subject Property on a long term basis.

The hearing

9. The appeal was first heard on 30 August 1999. The Taxpayer represented himself and gave evidence as the only witness. Miss Ngan for the Revenue conducted a very thorough cross-examination of the Taxpayer's finances and inquired into various deposits and withdrawals of the Taxpayer's bank accounts during the relevant period. The hearing was adjourned to give the Taxpayer an opportunity to check his records and refresh his memory on the various entries in his bank accounts. By a letter dated 1 October 1999, the Taxpayer provided to the Revenue a detailed 4 paged letter explaining the various deposits and withdrawals on which questions had been raised. He also annexed some 10 pages of bank statements and credit card statements in support. The Revenue raised further questions by a letter dated 6 October 1999 and the Taxpayer provided another 4 paged explanation and additional supporting documents. The hearing resumed on 30 December 1999.

The law

10. The legal principles in this area of the law is well settled.

11. Section 14 of the Inland Revenue Ordinance provides that profits tax shall be charged on any person carrying on a trade, profession or business in Hong Kong in respect of profits arising in or derived from Hong Kong from such trade, profession or business. Whether a person is carrying on a trade in buying and selling a property depends on his intention at the time of the acquisition: was it acquired with the intention of disposing it at a profits, or was it acquired as a permanent investment. The person's stated intention must be tested against the whole of the evidence. We remind ourselves that the onus of proof is on the Taxpayer to persuade us that the assessment is incorrect and that a single transaction can amount to an adventure in the nature of trade.

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The Taxpayer's case

12. The Taxpayer said that he was (and still is) an engineer working for Company A. At the time of purchase, his salary was \$50,000 a month. In addition he was entitled to 10% of his salary as shift allowance. In December of every year, he would be paid a bonus equivalent to one month additional salary. He produced his tax returns for the years ended 31 March 1996 and 1997. For the year of assessment 1996, his tax return showed total earnings of \$692,201 on top of the value for his quarters. For the year of assessment 1997, his tax return showed total earnings of \$766,434 again on top of the value for his quarters. If he was to acquire his own property, he would be paid an additional \$16,630 a month as housing allowance but he would have to vacate his quarters.

13. In order to acquire the Subject Property, he obtained an instalment loan of \$3,119,200 from Company D secured by an all monies mortgage on the Subject Property. The loan was repayable by 240 monthly instalments of \$30,620 each. In addition, he obtained a decoration loan of \$220,000 also from Company D. The loan was repayable by 36 equal monthly instalments of \$8,092 each.

14. The Taxpayer said he was financially capable of holding the Subject Property long term. He was single. He was living with his sister. He used to give his mother \$6,000 a month. However during the period he was holding the Subject Property, he stopped paying his mother any allowance. His main expenses was coursed by his gambling in Macau. His bank account was full of ETC withdrawals in Macau.

15. The downpayment was \$1,336,800. The Taxpayer produced tables, schedules and summaries supported by relevant documents explaining the source of the money for the downpayment and the whereabouts of the proceeds of sale. He had the support of his sister and his mother who lent a total of \$250,000 to him for the downpayment and he repaid them generously after the sale. In addition, he had made loans to his brother and his colleagues which he was expecting to be repaid. Together with his savings, his expected salary and his winnings from Macau, he was able to make the downpayment.

16. As to the reason for the purchase, the Taxpayer said he had always wanted to have his own property. He had a one-sixth share in a property which he held together with the rest of his family. The property was sold in 1988. He had a one-third share in a family property in District E which was the residence of his mother and his brother. He once purchased a flat in Hong Kong that was resold in 1987. He had no other property. He was aged 38 at the time of the purchase. Although he was provided with quarters and did not expect to retire until he was 60, he would need to sustain a mortgage loan over a period of some 15 or 20 years. Thus he thought it was the right time for him to buy. At the time, property prices was forever on the rise and property would become more and more out of reach.

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17. At the time of the purchase, car parks were not available for purchase. However that was not a main consideration. Later, when he received the developer's notice that car parks were available for purchase, he did not have time to arrange for the necessary financing.

18. Decoration of the Subject Property was completed in August 1996. He discussed it with his sister. It was a tough decision whether they should move there or sell. The main consideration was the downturn in his financial position. He had lost money in gambling during 1995 and 1996. As a result, he owned the credit card companies a total of \$144,935. In addition, he also owned his sister and his mother \$250,000.

19. Without a car park, they had to think of public transport. They would have to walk up to Road F or walk down Road G. It was inconvenient for his sister. The Subject Property was also far from his place of work. The Taxpayer said the location of the Subject Property was a factor to be considered but that was not the main reason for the sale.

20. At the time the property market was on the rise and he expected a handsome profit from the sale. That prompted him to sell and to repay his debts. After the sale, he repaid his sister \$300,000 and his mother \$200,000 which were double the loans they provided to him. In about a month after the sale, he also repaid the credit card companies.

21. He said that he has not given up looking for a replacement property and just recently he has applied to purchase a unit at District H, a Housing Society development. However he was unsuccessful.

The Revenue's case

22. We are very grateful to Miss Ngan for the Revenue who provided a very detailed written submission as to why the Taxpayer stated intention of purchasing the Subject Property as a residence could not be genuine.

23. It was submitted that in view of the provision of quarters by the employer and the Taxpayer's age at the time, he had a long way to go before retirement and there was no pressing need for him to purchase his own property.

24. The Subject Property was left vacant after completion and the Taxpayer did not apply for the housing allowance which would have greatly reduced his financial burden.

25. Since the sale, the Taxpayer had not acquired any replacement property. This is a factor to be taken against the Taxpayer since property prices had come down quite a lot since 1996.

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26. The Revenue also doubted the reasons for the sale. The location of the Subject Property could not be a reason for wanting to sell as this was already considered prior to the purchase. In any event, the Taxpayer completed the purchase in June 1996 and if location was a factor, he should have sold in June 1996 and not waste 2 months decorating the Subject Property. The inference is that he decorated it to enhance the resale value.

27. The lack of the car park could not be a relevant factor. There was no genuine desire to acquire a car park either for sale or for rental as there was little evidence of the Taxpayer having done anything to watch out for car parks available in the development.

28. With reference to the detailed financial position of the Taxpayer, the Revenue submitted that the Taxpayer had no pressing need to repay the outstanding indebtedness and they were not substantial when measured against his income. Thus the main reason given for the sale was suspect.

29. The Revenue submitted that the real reason for the sale was the handsome profit to be realized upon the disposal of the Subject Property.

30. The Revenue also analysed the Taxpayer's financial position and concluded that he was unable to sustain holding the Subject Property on a long term basis. The total mortgage payment was \$38,712 and he was only earning \$50,000 a month. The balance was insufficient for his daily expenses, to pay contributions to his parents and to save up for tax payments and so on. It is suggested that the accruing indebtedness to the credit card companies was evidence that the Taxpayer was unable to afford the Subject Property long term.

Reasons for decision

31. We considered all the evidence and all the submissions made. We have also closely observed the Taxpayer in his testimony before us. As to the Taxpayer's financial position, we are impressed by the very detailed explanations he has given. We are satisfied that based on his earnings, as stated in paragraph 12 above and despite his frequent visits to Macau, he was financially capable of holding the Subject Property long term. We also accept his explanations as to the source of the money for the downpayment of the Subject Property.

32. We have weighed the matters urged upon us by the Revenue. It is not necessary for the Taxpayer to persuade us that there was a pressing need for him to purchase his own property. Having considered the position of the Taxpayer, we are satisfied that it was reasonable for him to wish to acquire his own property even if he had the luxury of his free quarters. We would agree that the outstanding indebtedness of the Taxpayer at the time of the sale was not pressing. But again we do not think that it is necessary for the Taxpayer to persuade us that there was a pressing need to sell. We accept the Taxpayer's evidence that loans have to be repaid, it is merely a matter of timing. In the light of the handsome profit, the availability of the free quarters and the accruing

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indebtedness, we can understand why the Taxpayer changed his mind and preferred to sell the Subject Property instead. We have carefully observed the Taxpayer when giving evidence and we find him to be a credible witness. In the circumstances, we find that the Subject Property was purchased by the Taxpayer for use as the residence of his sister and himself. Accordingly we allow the appeal.