

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D113/97

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

Panel: Ronny Wong Fook Hum SC (chairman), Ma Ching Yuk and Andrew Mak Yip Shing.

Date of hearing: 25 October 1997.

Date of decision: 20 February 1998.

The taxpayers, Mr and Mrs A are husband and wife. On 28 March 1991, the taxpayers entered into a provisional agreement to purchase a property which was under construction at the time of purchase. The said property was assigned to the taxpayers on 18 December 1991. On 10 March 1992, the taxpayers entered into a provisional agreement to sell the property and the sale was completed on 23 April 1992.

The taxpayers' case was that the real intention for the purchase of the property was that the taxpayers had decided not to emigrate and therefore would need a permanent residence for the family and the subsequent sale of the property was to cater for medical expenses and funeral expenses of Mr A's father and their children's expenses in studying overseas. Having heard and observed Mr A, the Board find that the taxpayers' family never resided in the property and the property was sold shortly after completion. The Board was unable to accept Mr A's evidence as to their intention towards the property at the time of acquisition.

Held:

The stated intention of the taxpayers' cannot be decisive and the actual intention can only be determined upon the whole of the evidence. 'Intention' also connotes an ability to carry the same into effect. It is idle to speak of 'intention' if the person so intending did not have the means to bring it about or had made no arrangements or taken any steps to enable such intention to be implemented.

Appeal dismissed.

Cheung Lai Chun for the Commissioner of Inland Revenue.

Taxpayer in person.

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Decision:

The Facts

1. The Taxpayers ['Mr and Mrs A'] are husband and wife. They have two sons and a daughter. Their daughter left Hong Kong in September 1989 to study in Country B.
2. On 27 July 1990, the entire family was granted 'in-principle' approval for permanent residence in Country C. This approval was valid for a period of five years.
3. By an agreement dated 27 September 1990, Mr and Mrs A sold the flat they were then residing [Flat D] for \$1,600,000. Flat D was hitherto mortgaged in favour of a bank for \$450,000.
4. In 1991, Mr A was an employer of Company E. His salary was about \$32,000 per month with an additional rent allowance of \$2,250 per month. Mrs A was one of three partners in a fashion and tailor business which had its operation in a shop in District F. She drew \$32,500 by way of salary from that business in 1991.
5. The family of the Taxpayers moved from Flat D to a flat in District G ['Flat H']. Mr A rented this flat for two years under a written tenancy agreement dated 1 October 1990. The tenancy was renewed by another agreement dated 1 October 1992 for a further period of two years. Clause 8 of both agreements provided that the tenancy 'shall not be determined' until service of a six months' notice by either the tenant or the landlord.
6. Flat I:
 - a. On 28 March 1991, Mr and Mrs A entered into a provisional agreement to purchase Flat I for \$1,975,600. At the time of purchase, Flat I was under construction.
 - b. The purchase of Flat I was financed partly by a mortgage loan of \$1,700,000 granted by a credit company on 12 April 1991. This loan was to be repaid by 240 monthly instalments of \$16,405.40 each.
 - c. Flat I was assigned to Mr and Mrs A on 18 December 1991.
 - d. On 10 March 1992, Mr and Mrs A entered into a provisional agreement to sell Flat I for \$3,080,000. The sale was completed on 23 April 1992.
7. On 15 January 1993, Mr and Mrs A and their two sons were granted citizenship by Country J.
8. Mr K –father of Mr A

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- a. He first attended Dr L for treatment of chronic obstructive airway disease in September 1986. Between 1986 to July 1993, Mr K was admitted at least five times to hospital for treatment.
 - b. Mr K was last admitted into hospital on 24 July 1993. He passed away on 28 July 1993. Bronchopneumonia and chronic bronchitis were listed as causes leading to his death.
9. Shortly after the death of Mr K, Mr and Mrs A purchased Flat M at a consideration of \$2,567,000. Flat M was assigned in their favour on 15 December 1993. On the same day, Flat M was mortgaged in favour of another bank as security for general banking facilities extended by that bank. Mr and Mrs A have since been using Flat M as their residence.
10. The issue before us is whether Mr and Mrs A are liable to profits tax in respect of the profits arising from their disposal of Flat I.

Previous explanations by Mr and Mrs A

11. In his notice of appeal, Mr A gave the following reasons for the purchase of Flat I:
- ‘The real intention of the purchase was that the Taxpayer had decided not to emigrate and therefore would need a permanent residence for the family. Property price was (and still is) sky-rocketing and this property in District N was the only suitable and affordable property then.’
12. In response to the assessor’s enquiries as to why Flat I was left vacant, Mr A in a letter dated 29 June 1996 alleged that:
- a. ‘[Flat I] was left vacant during the period of ownership due to the worsening of the traffic condition in District N. I was working in the airport, my wife in District F and our two sons were studying in District O. No matter how early we got up, we ended up late for work/school.’
 - b. ‘The landlord of our leased flat refused our request of terminating our lease earlier unless paying a compensation of \$60,000’.
13. In the same letter, Mr A outlined his reasons for sale of the Flat I:
- a. ‘Our daughter went to Country B for her pre-college studies in 1989 and started her first year in college in 1991, tuition, boarding and other expenses had used up all our savings.’

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- b. 'My father was terminally ill and had to go in and out of the hospital every now and then.'
- c. 'Given the situations, I had to be prepared financially for my father's medical bills and ultimately, his funeral expenses.'
- d. 'We had to have some cash on hand for our two sons' future studies, for your information, both of them are now studying in Country P (first year in university)'.

The evidence given by Mr A before us

14. He is now 50. His father had a total of eight children. His brothers were in Country Q.

15. He cannot recall when he first applied for permanent residence in Country C. He applied in order to ensure some form of security. After he received the letter of 27 July 1990 from Country C government, Mrs A was reluctant to move as their sons would have to serve military service. In any event, the approval was valid for five years. He also cannot recall when he applied for nationality of Country J.

16. He gave two reasons for the sale of Flat D. First, he said he sold that flat in September 1990 in order to ensure that he had sufficient money for his daughter's education. Later on in his evidence, he explained that Flat D was in the names of his wife and his sister in law. His sister in law wished to marry and emigrate. Flat D was sold as a result of her insistence.

17. After he received 27 July 1990 letter from Country C government, he decided to locate a suitable residence. Premises in District G and District F were too expensive. Flats in District N were within his budget. His colleagues did warn him about District N's traffic before his purchase. He visited the area during his holidays and did not find conditions too unbearable.

18. He earned about \$40,000 per month in 1991. Out of this he had to remit \$1,000 per month to his daughter in Country B. After defraying other family expenses, he estimated that he had about \$10,000 per month by way of savings.

19. He was working in the airport when Flat I was purchased in March 1991. His wife attended her shop in District F and his two sons were studying in District O. After issuance of the occupation permit for Flat I, he visited the office of his landlord and sought to terminate the tenancy but there was uncertainty as to when actual possession of Flat I would be given to him. He spent \$80,000 decorating the flat. The family stayed there for several days. The boys had to spend on the average three hours per day for their school journeys. Living in that flat was therefore not a feasible proposition. The Flat was then sold through a friend of him in March 1993.

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20. His father was residing with his sister prior to his death. He had to pay for his father's medical expenses because his sister had already contributed by living with his father. He did approach various hospitals and physicians for details of the medical expenses involved but had limited success due to lapse of time.

21. Shortly after the purchase of Flat M in November 1993, his sons left Hong Kong in January 1994 for study in Country P.

The applicable principles

22. The principles are well known. We have to ascertain the Taxpayers' intention at the time of the acquisition of Flat I. The stated intention of the Taxpayers cannot be decisive and the actual intention can only be determined upon the whole of the evidence. We must consider all the objective circumstances to see if the Taxpayers had a genuine, realistic and realisable intention in investing in Flat I. 'Intention' also connotes an ability to carry the same into effect. It is idle to speak of 'intention' if the person so intending did not have the means to bring it about or had made no arrangements or taken any steps to enable such intention to be implemented.

23. Section 68(4) of the Inland Revenue Ordinance (the IRO) provides that the onus of proving that an assessment is incorrect rests with the taxpayer. It is his burden to produce the relevant evidence of what happened with respect to the transaction which resulted in the profits in question.

Our decision

24. We find the letter of 27 July 1990 from Country C government granting the Taxpayers' family 'in-principle' permanent residence of limited relevance. It was valid for five years. It operated as a safety net for the family should need arise. We doubt if Mr and Mrs A ever intended to leave Hong Kong for Country C.

25. Flat D was sold on 27 September 1990. Mr A says that the sale arose as a result of pressure from his sister-in-law. We have difficulty in following his reasoning given the fact that his sister-in-law's half share was transferred to Mr A on 17 April 1989. Flat D was thereafter owned entirely by Mr and Mrs A. If the couple wished at that juncture to have a permanent family home, we find little justification in selling Flat D. If they were harbouring a desire to leave Hong Kong, it is inconsistent with Mr A's commitment to a two-year tenancy for Flat H which tenancy called for a six months' notice of termination.

26. The sale of Flat D and the purchase of Flat I took place within a space of less than five months. Given this time frame, we find it difficult to accept Mr A's contention that Flat I 'in District N was the only suitable and affordable property then.' Mr A voiced no objection in relation to the location or physical attributes of Flat D. We were not told how the lapse of five months rendered premises in the vicinity of Flat D unaffordable. Mr A had not produced any evidence indicating the financial position of the couple after the sale of Flat D. The importance which he attached to the education of their children casts serious

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doubts on his alleged suitability of Flat I. The family stayed in Flat H until the two sons left for education in Country P.

27. Apart from Mr A's bare assertion, we have no evidence to support the alleged expenditure of \$80,000 in decorating Flat I. The subsistence of tenancy for Flat H coloured his claim that the family stayed in Flat I for a couple of days.

28. Flat I was allegedly sold to cater for medical expenses of Mr K. According to Dr L, Mr K's medical conditions were traceable to at least September 1986. He was admitted to hospital for at least five times since 1986. There is no evidence to suggest any significant deterioration in 1992. There is also little evidence as to the couple's financial position before and after the sale of Flat I in March 1992. Mr K passed away on 28 July 1993. Flat M was purchased on 26 September 1993. In these circumstances, it is unlikely that Mr K's medical expenses in 1992-1993 created any undue burden on the resources of the family.

29. We recognise the strength of Mr A's case arising from his purchase and continued residence in Flat M. However we accept the submissions from the Revenue that circumstances had drastically changed in that the two boys had by this stage left for education in Country P. There was no further incentive to live near their school in District P.

30. We find that the family never resided in Flat I. The Flat was sold shortly after completion. Apart from the motivation for profit, we do not accept that there was any other reason leading to its sale. Mr and Mrs A failed to discharge the onus on them under section 68(4) of the IRO and we dismiss their appeal.