

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D117/99

Profits Tax – real property – whether the gains arising from the disposal of a property was liable for profits tax – sections 2, 14 and 68(4) of the Inland Revenue Ordinance.

Panel: Audrey Eu Yuet Mee SC (chairman), Jiang Zhaodong and Duffy Wong Chun Nam.

Date of hearing: 14 January 2000.

Date of decision: 8 February 2000.

The taxpayers, Mr and Mrs A, are husband and wife. In November 1989, the taxpayers entered into an agreement to purchase Property 1 which at the time was still under construction. In January 1991, Mr and Mrs A signed a confirmation to purchase the Subject Property (in District C) which at the time was still under construction. On 10 April 1991, Property 1 was assigned to the taxpayers. Mr A's family of six persons and his mother-in-law moved into Property 1 and are still residing there. On 9 January 1992, the taxpayers sold the Subject Property as confirmors for a gain.

In May and July 1997, Mr A wrote to the Revenue and gave the first reason for the sale of the Subject Property. Mr A stated that sale proceeds of the Subject Property was put into a proposed business investment in Country F in an attempt to proceed to immigration. However the proposed investment turned out to be 'disagreeable', the fund was later used to purchase another property held through a limited company.

In August 1997, Mr A gave a second reason for the sale of the Subject Property. Mr A stated that the Subject Property was bought and was intended for own use but it was sold before the completion of sale and purchase took place because of long traffic time required for his children to attend work or school.

The Commissioner disbelieved the claim and gave her decision on 26 May 1999. By a letter dated 4 November 1999 the taxpayers reiterated their intention to purchase the Subject Property as being 'for residential purpose so as to improve our family members' quality of life – an intention prompted by the growth of our children and frustrated by the traffic problem in District C and the subsequent intention to immigrate to Country F'.

Shortly before the hearing Mr A put in a supplemental statement and for the first time it was stated that immigration to Country F was not the reason for the sale of the Subject Property. Again for the first time it was suggested that the intention might not be for the whole family of Mr A to

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move to the Subject Property. Mr A explained that the intention was to keep both Property 1 and the Subject Property and have one daughter occupying one property for use as her eventual matrimonial home. As none of them were willing to move to the Subject Property, the taxpayers therefore decided to sell the property without taking conveyance.

Held:

- (1) The taxpayers have to persuade us that the assessment was incorrect. They have to show us that the intention at the time of the acquisition was not for trading but for long term holding as capital asset. Furthermore it was not merely what they claim to be their intention, they have to show us that the intention was realistic and realisable.
- (2) The taxpayers' case as to who was to reside in the Subject Property was confusing. They have also given different and changing reasons for the sale of the Subject Property. The evidence of the taxpayer was not accepted.

Appeal dismissed.

Cases referred to:

Simmons v CIR [1980] 1 WLR 1196
All Best Wishes Ltd v CIR 3 HKTC 750

Cheung Mei Fan for the Commissioner of Inland Revenue.
Ho Chi Ming instructed by Messrs W H Lam & Co for the taxpayer.

Decision:

The appeal

1. The Taxpayers Mr A and Ms B (' Mrs A ') are husband and wife. They appeal against the determination of the Commissioner of Inland Revenue dated 26 May 1999 in respect of the profits tax assessment raised on them for the year of assessment 1991/92. They claim that the gains from the disposal of the subject property namely a unit and a car parking space at District C (' the Subject Property ') should not be subject to profits tax.

The facts

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2. The background facts are not in dispute.
3. For many years, Mr A's family lived in a public housing estate at District D. This consisted of then seven persons, the Taxpayers Mr and Mrs A, their two daughters, one son, and the parents of Mrs A, Mr and Mrs B. The living condition was extremely crowded. The unit was about 400 square feet. Two bedrooms were partitioned off, one for Mr and Mrs A and the other for Mr and Mrs B. The children slept in makeshift beds in the living area. These beds were laid out for the night and gathered up in the morning. It was inconvenient particularly for the two grown up daughters. They were impatient to improve their living conditions.
4. On 9 November 1989, Mrs A entered into an agreement to purchase a unit at District E (' Property 1 ') at \$1,375,430. At the time of purchase, Property 1 was still under construction. The gross floor area was 815 square feet and there would be three bedrooms. The purchase was financed by means of a bank mortgage loan of \$1,000,000 which was repayable by 180 monthly instalments of \$11,054 each.
5. On 9 September 1990, Mrs A's father, Mr B died of lung cancer.
6. On 9 January 1991, Mr and Mrs A signed a confirmation to purchase the Subject Property for \$1,636,160. At the time, the Subject Property was under construction. The purchase was financed by means of an equitable mortgage on the Subject Property for \$1,472,544. The loan was to be repaid by monthly instalments of \$14,211 each. The gross floor area was 928 square feet and there would also be three bedrooms.
7. On 10 April 1991, Property 1 was assigned to Mr and Mrs A as joint tenants. On the same date, Mrs A also purchased a car parking space of Property 1 development for \$200,000. Mr A's family of six persons, Mr and Mrs A, their three children and the mother-in-law moved into Property 1 and are still residing there today. Mr and Mrs A occupied one bedroom, the two daughters one and the remaining one was shared by the son and his grandmother.
8. On 9 Jan 1992, Mr and Mrs A sold the Subject Property as confirmors for \$2,880,000. The sale was completed on 23 Jan 1992. The issue was whether the gain from the disposal of the Subject Property ought to be subject to profit tax.

The Taxpayer's initial claims

9. On 29 May 1997, Mr A wrote to the Revenue stating that sale proceeds of the Subject Property was put into a proposed business investment in Country F in an attempt to proceed to immigration. However the proposed investment turned out to be ' disagreeable ', the fund was later used to purchase another property held through a limited company.
10. On 8 July 1997, Mr A wrote to the Revenue and referred to the earlier letter dated 29 May 1997 as the reason for selling the property. That was the first reason that he gave for the sale.

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11. This was followed by a letter dated 13 August 1997 where Mr A gave the reason for purchasing the Subject Property as follows:

‘the above property was bought and was intended for own use, as it was 14% bigger than Property 1 we live in.’

It was not stated who would be residing in the Subject Property but from the reference to 14%, it would seem that the intention was for the whole family of Mr A to move to the Subject Property. In the same letter, Mr A gave the reason for selling as follows:

‘As the property is located at a district which takes long traffic time to school in District G for my son, and on Hong Kong side for my second daughter, as well as to an employment on Hong Kong side for my eldest daughter, it was not kept as intended and was then sold before the completion of sale and purchase took place.’

That appears to be the second reason he gave for selling the Subject Property.

The determination

12. The Commissioner of Inland Revenue gave her decision on 26 May 1999. She upheld the assessment. She disbelieved the claim that the Subject Property was for self use. The parties had already purchased Property 1 for their residence. Mr and Mrs A sold the Subject Property without taking possession of it. If the genuine reason for acquisition was for their own residence, the traffic problems would have been considered before they decided on the purchase. As for the alleged investment for immigration purpose, no evidence was adduced to show any investment plan or any application for immigration.

The Taxpayer’s subsequent claims

13. After the determination, by a letter dated 4 November 1999 to the Revenue, Mr and Mrs A reiterated their intention to purchase the Subject Property as follows:

‘for residential purpose so as to improve our family members’ quality of life – an intention prompted by the growth of our children.’

They claimed that their intention was frustrated by the traffic problem in District C and the subsequent intention to immigrate to Country F. They obviously received some professional advice at the time as their letter quoted legal arguments and the relevant case law.

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14. This was closely followed by Mr A's first witness statement which was (according to the index of the bundle) dated 10 November 1999. He said that at the time Property 1 was purchased, it was intended that only five persons, namely Mr and Mrs A and the three children would move there. Mr and Mrs B were to remain at the public housing estate. However the father-in-law died and they did not want to let the mother-in-law live alone. So they looked for a larger property but property prices had gone up. They decided on the Subject Property as it was from the same developer as Property 1, it was of the right size and it was within their price range. As for the reasons for sale, Mr A referred to their plan to immigrate to Country F. After the purchase and before they moved into the Subject Property, they discovered the traffic problem there, in particular, the distance from the Subject Property to the MTR station was entirely beyond their original expectation. As they knew someone from the developer, they were able to inspect the Subject Property without having completed the purchase. Mrs B was complaining that the shower basin was too high for her to climb into and moving to District C would take her away from her friends. The location was also inconvenient for the children. The eldest daughter found a job in District H at Hong Kong side. The second daughter was also attending school in District H and the son was studying in District G at Kowloon side. There was mention for the first time the idea of reserving the Subject Property for one of the daughters as her home after her marriage. That idea was premature and they decided to dispose of the Subject Property.

15. Shortly before the hearing, Mr A put in a supplemental statement received by the Board on 10 January 2000. For the first time, it was stated that immigration to Country F was not the reason for the sale of the Subject Property. Corresponding changes were made to the first witness statement. For the first time, it was suggested that the intention might not be for the whole family of Mr A to move to the Subject Property. Mr A explained in his supplemental witness statement:

'Property 1 development was completed in April 1991. We decided to keep both Property 1 and the Subject Property. Our intention was to have one daughter occupying one property for use as her eventual matrimonial home.' *'Our original plan was to transfer one property to one of our two daughters as her matrimonial home. None of them were willing to move to the Subject Property. Naturally they were unwilling to finance the monthly mortgage instalments. We therefore decided to sell the property without taking conveyance.'*

So a third reason was given for the sale of the property. It was originally intended that the two daughters would between them contribute to the mortgage payments of the Subject Property. But neither of them was willing to do so. Mr and Mrs A were therefore forced to sell.

The hearing

16. The Taxpayer called two witnesses, Mr A and the eldest daughter Ms A.

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17. Mr A confirmed his first witness statement as corrected by his supplemental statement. He said the decision to purchase the Subject Property was made by him and his wife alone. None of the other family members were consulted prior to the purchase being made. The intention was for the whole family to move there or for part of the family to move there and part of the family to remain in Property 1 depending on who would find it more convenient to stay in which property.

18. At the time the joint income of Mr and Mrs A was about \$24,000 a month. Thus the combined monthly instalment payments for Property 1 and the Subject Property would exceed their joint income. However they were expecting their daughters to contribute. At the time the Subject Property was purchased, both daughters were studying. The eldest daughter was about to finish her education in the university and he expected her to find a job. She was giving the parents about \$3,000 to \$4,000 a month. The tax return of the eldest daughter was produced showing that for her first job from November 1991 she was earning some \$4,000 a month. As for the second daughter, she only started earning after the Subject Property was sold. The youngest son was still at school. Mr A said that their daughters would give private tuition and received some income therefrom. Although the daughters were expected to contribute, they were not consulted prior to the purchase. Mr A explained that he had to make up his mind to buy the Subject Property instantly and if he relayed the idea to his daughters subsequently, he thought they would agree. His intention was that he and his wife would pay for the down payment and the two daughters would jointly be responsible for the mortgage. He was not sure how much the daughters could contribute as it would depend on their income. It was suggested to him that it might be unfair if the Subject Property was later only given to one daughter but both of them had to contribute. Mr A said he 'did not think of such long term thing' but he expected both of them to contribute. He thought he being the father would be authoritative enough to decide but as to the actual disposal he repeated that he 'did not think of such long term thing'. Even after the purchase, they never discussed this formally with either of the daughters until the Subject Property was almost ready for completion. He was asked why he did not do so earlier if he expected his daughters between them to contribute towards the mortgage payments. This would mean something like \$7,000 a month for each daughter. He replied that he thought it was 'unreasonable' if he were to tell them to pay the money. When they finally raised this with the two daughters, it was about the time they had to take possession of the Subject Property. Neither daughter was willing to contribute towards the mortgage. He said it was a matter of 'family shame' and that was why he did not mention this before in any of his previous correspondence with the Revenue.

19. As for the traffic or the location problem, he said it was one of the reasons for the sale but not the main reason. He was shown the sales brochure of the Subject Property development which showed very clearly that there was some distance from the development to the MTR station. Since he had seen the show flat at the site prior to the purchase, he should be aware of the problem. Mr A admitted there were often traffic congestion and one had to take a mini bus to get from the development to the MTR station. He said the problem existed at the time he purchased the Subject Property but he did not realize it then. He was asked why he did not mention the traffic reason in his

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earlier correspondence with the Revenue and he said it might be at that time he did not think it was an adequate reason.

20. The eldest daughter gave evidence. She said that they were not consulted prior to the purchase of the Subject Property. They learnt of it shortly thereafter. It was mentioned that the whole family might have to move there but there was no definite date. Later it was informally mentioned that the two daughters would be expected to contribute towards the mortgage. She saw no reason to object. She was contributing \$3,000 or \$4,000 to her parents a month and they were free to use the money for whatever purpose including the payment of the Subject Property mortgage. At some stage, it was suggested that the two daughters might be moving to the Subject Property instead of the whole family. When the Subject Property was ready for possession, the whole family went to see it in late 1991. At about the time, she and the younger sister were asked to be responsible for the mortgage. She and her sister rejected this proposal as the Subject Property was in the name of the parents and there was no clear indication as to the future ownership. Furthermore if they were to get married in future, there would be two separate households and they could not be expected to live in the Subject Property together.

Reasons for decision

21. The law in this area is well settled. The Taxpayers Mrs and Mrs A have to persuade us that the assessment was incorrect. They have to show us that the intention at the time of the acquisition was not for trading but for long term holding as capital asset. Furthermore it was not merely what they claim to be their intention, they have to show us that the intention was realistic and realisable. We have been referred to sections 2, 14 and 68(4) of the Inland Revenue Ordinance as well as Simmons v CIR [1980] 1 WLR 1196 and All Best Wishes Ltd v CIR 3 HKTC 750.

22. A property may be purchased as an investment for rental purpose or for residence. In either case, this would be a purchase of a capital asset. In the present case, the Taxpayers claim that they purchased the Subject Property as a residence. It was never claimed that they purchased it for rental income. So we have to examine if the reason which the Taxpayers have put forward for the purchase was genuine and realistic.

23. The Taxpayer's case as to who was to reside in the Subject Property was confusing. Initially it was claimed that the whole family of six persons were to move there. There was otherwise no need to purchase a property larger than Property 1. Mr A said that the son would prefer not to share a room with the grandmother, but both Property 1 and the Subject Property only had three bedrooms so the son would probably have to share a room with his grandmother either way. There was an initial suggestion of a store room in the Subject Property for Mrs B, but this was dropped when it was clear from the sales brochure floor plan that there was no store room. When it was suggested to Mr A that the location of the Subject Property might be inconvenient to some of the family members, he said it was impossible to suit everybody and those who would find the property convenient could move there. If the intention was for the whole family to move to the

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Subject Property, then it was odd that Mrs B should purchase the car park in Property 1 in April 1991, 3 months after the purchase of the Subject Property. Counsel for the Taxpayers explained that it was because the Taxpayers intended to keep both properties, so a car park for each property was useful for the family. However, the reality was that Mr A's family could not financially afford to reside in both properties. They might be able to keep both properties by residing in one and renting the other out but the total income (including the expected income) from the whole family appeared insufficient if they were to reside in both properties. The Taxpayers had failed to persuade us how they could afford to live in both properties, each with a car park, and sustain the mortgage payments on a long term basis. The Taxpayers have also failed to persuade us that there was a genuine intention to purchase the Subject Property for their own residence.

24. The Taxpayer have also given different and changing reasons for the sale of the Subject Property. The first reason was that they had to invest for immigration purpose. That reason is now totally abandoned. Counsel for the Taxpayers explained that the mistake was due to Mr A's confusion between the reason for selling and the use of the proceeds of sale. We are not convinced that he was so mistaken. We note that the letter of 8 July 1997 was not in response to any query but was his notice of objection and 'reason for selling it' were words of his own choice rather than a response to a query from the Revenue. It is also obvious to us during the hearing that Mr A knew some English as he often gave his answers even before the questions were interpreted to him. More importantly, the main reason he now relies on for the sale of the Subject Property, that his daughters refused to contribute towards the mortgage, was only given in his supplemental statement in January 2000. We do not accept his explanation that he did not give this reason earlier as it was a matter of 'family shame'. We also do not accept his evidence that he intended the two daughters to contribute towards the mortgage. The daughters were not even working at the time the Subject Property was purchased. It was not known how much either or both of them would make when they did secure a job. More importantly, if the Taxpayers genuinely expected the daughters to be responsible for the mortgage and to move to the Subject Property on their own, they would not have failed to discuss this with them until it was almost time to complete the purchase. Even Mr A had to admit in cross examination that he did not think the whole thing through on a long term basis. It was also incredible that he should expect the two daughters between them to contribute towards the mortgage without even considering the future entitlement of the property. In short, we do not accept the evidence of Mr A. The evidence of the eldest daughter does not help to prove the Taxpayers' case. If anything, it showed that the Taxpayers did not genuinely intend for the daughters to be responsible for the Subject Property's mortgage payments on a long term basis.

25. In the circumstances, the Taxpayers have failed to discharge their onus to persuade us that the assessment was incorrect and we would dismiss the appeal accordingly. As for the amount of the profit and the tax payable thereon, we understand that this is still subject to dispute. We would leave it to be agreed between the parties failing which the matter can be restored before us for further argument.