

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D121/95

Profits tax – sale of property – intention – acquisition for use as residence.

Panel: Robert Wei Wen Nam QC (chairman), Ng Yin Nam and Herbert Tsoi Hak Kong.

Dated of hearing: 14 December 1995.

Dated of decision: 8 March 1996.

The taxpayers claimed that the property in question was acquired for use as a residence. One of the taxpayers had no plans to become a property owner, and took the quarter share of the property reluctantly and without being able to sustain the burden of the monthly instalments. The right to use the property as residence was contingent.

Held:

The onus is on the taxpayers to prove that intention of holding the property as a long-term investment at the time of acquisition. Taking together the uncertainties attending the right to use the property as a residence, the taxpayers failed to prove the intention to hold the property as a long-term investment to be genuinely held, realistic and realisable.

Appeal dismissed.

Cases referred to:

All Best Wishes Ltd v CIR 3 HKTC 750
D11/80, IRBRD, vol 1, 374

Ng Kwok Yin for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Introduction

1. This is an appeal by four Taxpayer (T1, T2, T3 and T4) against the profits tax assessment raised on them for the year of assessment 1991/92 and revised by the Commissioner of Inland Revenue in his determination dated 31 March 1995. They claim

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that the property in question (the subject property) was acquired for use as a residence, and therefore that the profit made on its disposal is not subject to profits tax.

2. T1 is the husband of T2. T3 and T4 are the sisters of T2.
3. At the hearing of this appeal, T1, T3 and T4 appeared in person and gave evidence. T2 was absent.

Facts not in dispute

4. At all relevant times, T1 and T2 with their 10-year-old son and 8-year-old daughter resided at a government married quarter while T3 and T4 resided at a flat owned by their mother.

5. On 24 September 1990 and by a memorandum for sale of that date, T1, T2, T3 and T4 (hereinafter collectively called the Taxpayers) purchased the subject property, a flat then under construction for \$1,082,000.

6. The purchase of the subject property was financed as follows:

- (a) by a deposit of \$482,000 made up of:
 - (i) a sum of \$241,000 from T1 and T2; and
 - (ii) a sum of \$241,000 from T3 and T4, of which \$200,000 was obtained from their mother; and
- (b) by a mortgage loan of \$600,000 obtained from a finance company repayable by 180 monthly instalments of \$6,819 each.

7. The monthly instalments of \$6,819 each was contributed to by the Taxpayers as follows: as to 50%, that is, \$3,409 by T1 and T2, and as to 25%, that is, \$1,704, by each of T3 and T4.

8. The annual income of the Taxpayers was respectively as follows:

| | 1990/91 | 1991/92 |
|----|----------------|----------------|
| | \$ | \$ |
| T1 | 183,575 | 196,994 |
| T2 | - | - |
| T3 | 39,600 | 40,800 |
| T4 | 60,600 | 68,410 |

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9. T3 and T4 paid their shares of the monthly instalments out of their monthly salaries (annual income shown above divided by 12). T4 paid a further sum of \$1,500 per month towards household expenses.

10. On 23 June 1991 an occupation permit, and on 10 July 1991 a letter of compliance, were respectively issued in respect of the subject property.

11. On 13 July 1991 and by a provisional agreement of that date the Taxpayers as sub-vendors sold the subject property for \$1,570,000. The sale was completed by a direct assignment from the developer to the sub-purchaser.

12. In a letter dated 26 July 1994 and signed by all the four of them, the Taxpayers, in answer to the assessor's inquiries, named themselves and the two children of T1 and T2 as persons who intended to reside at the subject property.

13. In their letter to the assessor dated 2 September 1994 and signed by all the four of them, the Taxpayers stated in the last paragraph the following:

'[T4] did not expect the hardship of bearing the monthly instalment was so great before acquisition of the property. The rest of money after paying the monthly instalment was difficult to afford her normal expenditure, therefore she insisted to sell the [subject] property.'

We accept that statement.

14. The profits tax assessment for the year of assessment 1991/92 was revised by the Commissioner of Inland Revenue in his determination dated 31 March 1995 as follows:

| | |
|---|---------------|
| Profits per account submitted by the Taxpayers | \$417,076 |
| Add capital portion of the instalments | <u>14,360</u> |
| | \$431,436 |

Grounds of appeal

15. The statement of grounds of appeal dated 27 April 1995 was signed by all the four Taxpayers and was to the following effect:

- (a) The Taxpayers purchased the subject property merely for residential use, and never had intention to use it for gaining profits. At the time of purchasing the subject property, the Taxpayers planned that it could be occupied by T3 and T4

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after their marriages or by T1's family (that is, T1, T2, and their two children), depending upon the question of whose need would be the greatest.

- (b) T4 insisted on disposing of the subject property because she could not afford the monthly instalment. The other three Taxpayers wished to retain the subject property but they could not afford to take over the share of T4 due to financial problems.
- (c) Since September 1990, there has been only one purchase/sale of property. The Taxpayers have their own jobs and have never participated in any kind of trade, profession or business during these years. Therefore their disposal of the subject property should not be termed a trade or an adventure.
- (d) Up to the present moment, purchasing a house as residence is still their need. T1 and T2 are applying to purchase a house from the Hong Kong Housing Authority under the Home Ownership Scheme.
- (e) Comparing the current prices with those of the early 1990's, the Taxpayers actually have lost a lot of money from the sale of the subject property instead of gaining any profit.
- (f) The Taxpayers should not be charged to profits tax under the Inland Revenue Ordinance because they have not carried on any trade, profession or business in Hong Kong.

Evidence

16. T1's evidence may be summarised as follows:
- (a) T1, T2 and T3 did not have enough money among themselves to purchase the subject property, so they pressured T4 to join in, which she did reluctantly.
 - (b) The subject property was sold in July 1991, that is, 9 months after the purchase. During that period there were disagreements among the Taxpayers because T4 could not afford to pay her share of the monthly instalments and wanted to sell the subject property. T1, T2 and T3 did not have the means among themselves to take over T4's quarter share. To avoid further disagreement, the Taxpayers sold the subject property.
 - (c) They sold it in a rising market. A decision had been made on the airport. They would have sold for \$1,300,000 to \$1,400,000 but there was a delay because T1 and T2 were busy applying for a visa to the USA. They sold for over \$100,000 more due to the delay. Had they delayed further, they would have sold for an even higher price.

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- (d) T3 and T4 were single in September 1990. T3 married in 1994 while T4 is still single. T1 and his wife T2 together had a half share in the subject property, while T3 and T4 each had a quarter share.
 - (e) They purchased the subject property for use as a residence. The question who was to occupy the subject property would depend on the circumstances. Their idea was that whoever had the greatest need should occupy. T3 and T4 would have a need when they married. In reality there were only three and not four co-owners, T1 and T2 being one co-owner. The co-owners had a real need for a flat to live in. The object of the purchase was to put money into the property and use it as a residence.
 - (f) In June 1995 T1 and T2 successfully applied for the purchases of a flat under the Home Ownership Scheme for \$1,364,500. In September 1990 T1 did not apply under that Scheme because (1) there was no suitable location and (ii) he would have had to surrender his married quarter. At the end of 1991 or the beginning of 1992 he had applied under the Scheme but was not successful because there were too many applicants.
 - (g) At the time of the purchase, no one could tell whether or when T3 or T4 could get married, although T3 had a boy friend who she married in 1994. In that year T3 bought a small second-hand flat for her marriage.
 - (h) They all had their jobs. T2 was a housewife. T3 worked in a factory. T1 was a civil servant. T4 also worked. No time for commercial activities. From 1990 up to now, they only bought and sold one unit. T1 could pay the instalments for his flat under the Scheme because he had government subsidy.
 - (i) In 1990 T1 and T2 had a son aged 10 and a daughter aged 8.
 - (j) In the beginning, when they asked T4 to participate in the purchase, she reckoned that after paying her share of the monthly instalment, she would be left with over a thousand dollars to spend. It seemed to her that this would be an uphill struggle. After being urged to do so, she agreed to join in, but only reluctantly.
17. Briefly, T3's evidence is as follows:
- (a) At the time of the purchase, their idea was that whoever had the need should occupy the flat and pay a proportionate part of market rent to the other co-owners. (This was an interjection by T3 while T1 was giving evidence; T1 agreed.)
 - (b) Her mother gave her and T4 each a sum of \$100,000 to help them pay the down payment. There was no need to repay. In fact she offered to repay the sum of \$100,000, but her mother said there was no need to do so.

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18. T4's evidence may be summarised as follows:
- (a) In the beginning she had no plans whatsoever to become a property owner. Without her knowledge, the other three went ahead with the purchase. When making the purchase, they put down T4's name as one of the purchasers (this presumably refers to the memorandum for sale dated 24 September 1990 (see para 5 above) which named all four Taxpayers as purchasers but was not signed by or on behalf of T4). Having made the purchase in this way, they then told T4 about it. T4 felt there was nothing for it but to join in the purchase. She did not see clearly the difficulties that lay ahead.
 - (b) She was attending evening courses and had a wish to enrol at a local Institute of Hong Kong to further her studies, but could not afford the high tuition fees.
 - (c) After paying several monthly instalments, she began to feel the pinch; the difficulties had begun to bite. She discussed with the three co-owners her proposal to sell the subject property; in the end they had no choice but to agree.
 - (d) She applied for enrolment at the Institute soon after the subject property had been sold but did not commence her studies until April 1992 for lack of a vacancy.

We accept T4's evidence as summarised above.

Onus of Proof

19. (1) The main thrust of the Taxpayers' case is that, at the time of acquisition, their intention was to hold the subject property as a long-term investment, that is, for use as a residence by T3 or T4 after their respective marriages or by T1, T2 and their children, whichever of the three clusters had the greatest need.
- (2) The onus is on the Taxpayers to prove that intention.
- (3) To do so, they have to show (a) that their intention was 'genuinely held, realistic and realisable' (see All Best Wishes Ltd v CIR 3 HKTC 750 at 771), and (b) that they were able to carry that intention into effect, for it is idle to speak of 'intention' if the person so intending does not have the means to bring it about (see Case No D11/80, IRBRD, vol 1, 374 at 379).
- (4) This being a case of co-ownership, the intention and the ability to carry it into effect must be proved in respect of each co-owner individually and in respect of all the co-owners collectively.

Reasons

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A. T4's participation

20. T1, T2 and T3 did not have sufficient resources among themselves to purchase the subject property, so they pressured T4 to join in the purchase (see T1's evidence at paragraph 16(a) above which we accept). Without T4's knowledge, they made the purchase in the names of all four Taxpayers; they then informed T4 about it. Feeling that she had no choice, T4 became a co-owner, but reluctantly. She sensed that it would be an uphill struggle for her (see T1's evidence at paragraph 16(j) above which we accept) but did not see the difficulties clearly. After several monthly instalments had been paid, the difficulties began to bite. She was having difficulties defraying her normal expenses after paying the instalment out of her monthly salary. She could no longer carry the burden of the instalments. The other three co-owners lacked the means to take over T4's quarter share (see T1's evidence at paragraph 16(b) above which we accept).

B. The sale

21. So the subject property had to be sold and that was done in July 1991, shortly after the occupation permit and the letter of compliance had been issued. It was sold under a provisional agreement for sale and purchase by the Taxpayers as sub-vendors. The subject property was assigned directly by the developer to the sub-purchaser, thus rendering unnecessary an assignment by the developer to the Taxpayers on which the Taxpayers would have had to pay stamp duty and attendant costs.

C. The intention

22. T4 acquired a quarter share in the subject property and a right to use it as her residence subject to payment of a proportionate part of market rent to the other co-owners (see T3's evidence at paragraph 17(a) above which we accept). The right was contingent on (i) her need for a residence (or her and her husband's need if she married) being greater than the need of the other co-owners and (ii) her ability to pay 75% of market rent to the other co-owners. At the time of the acquisition, it was unknown whether or when T3 or T4 would marry. As it has turned out, T4 has remained single to this day, while T3 had a boy friend at the time of acquisition whom she married in 1994 (see T1's evidence at paragraph 16(d) and (g) above which we accept). It was unknown whether her need for a residence would be the greatest. It was unknown whether she could afford the rent. If the contingencies were not all satisfied, T4 could end up receiving a quarter share of market rent or nothing in case the subject property was not occupied at all.

23. T1, T2 and T3 did not have the means among themselves to purchase the subject property. They needed T4's assistance to make the purchase possible. On the other hand, T4 had no plans whatsoever to become a property owner. She sensed that to join in as a quarter share co-owner would be an uphill struggle. However, as the other three had already used her name in purchasing the subject property, she felt she had no choice but to join in, but she did so reluctantly.

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24. At first T4 did not see the difficulties clearly. After several monthly instalments had been paid, the difficulties began to bite. She was having difficulties defraying her normal expenses after paying the instalment out of her monthly salary. Her expenses at this stage did not include the tuition fees for the Institute courses as she did not become a student of that Institute, nor were the fees payable, until some months after the sale of the subject property. She simply could not afford to pay any more instalments. Her inability to sustain the instalments had its root cause in her financial inadequacy which was present from the moment of acquisition of her quarter share in the subject property. Although the inability took several months to manifest itself, T4 in fact took the quarter share without being able to sustain the burden of the monthly instalments.

Conclusion on ground (a)

25. Taking together the uncertainties attending the right to use the subject property as a residence (see paragraph 22 above), the fact that T4 had no plans to become a property owner and took the quarter share reluctantly (see paragraph 23 above) and the fact that she acquired the quarter share without being able to sustain the burden of the monthly instalments (see paragraph 24 above), we find it impossible to say that the Taxpayers have proved on a balance of probabilities (a) that, at the time of the acquisition, T4 had a genuinely held, realistic and realisable intention to hold her quarter share as a long-term investment, or (b) that the Taxpayers as a group had at the time of the acquisition a genuinely held, realistic and realisable intention to hold the whole of the subject property as a long-term investment. Ground (a), the main ground of appeal (see paragraph 15(a) above), therefore fails (see paragraph 19 above).

Other grounds of appeal

26. Before concluding this decision, we shall deal briefly with the other grounds of appeal (see paragraph 15 above).

- (a) Grounds (c) and (f). By definition, 'trade' includes an adventure in the nature of trade (see section 2 of the Inland Revenue Ordinance). The issue is whether the purchase and sale of the subject property amounted to an adventure in the nature of trade. The onus is on the Taxpayers to prove that there was no such adventure. They sought to discharge the onus by proving that the subject property was acquired for use as a residence, that is, as a long-term investment, the argument being that to sell a long-term investment does not amount to an adventure in the nature of trade. But they have failed to prove that the subject property was a long-term investment; hence they have failed to prove that its purchase and sale did not amount to an adventure in the nature of trade.
- (b) Ground (b) states in effect that at all relevant times the Taxpayers needed to purchase a house (meaning a residence, we think). This goes back to the assertion that the Taxpayers bought the subject property as a residence, that is, as a long-term investment. But they have failed to prove that assertion.

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- (c) Ground (e) argues that the Taxpayers have not made any profit from the sale of the subject property but have made a loss because the market has gone up since. The argument is misconceived. Profit is the amount by which the price of the sale exceeds the cost of the purchase. There is no doubt in our minds that the Taxpayers made a profits from the sale.

Decision

27. For the above reasons this appeal is dismissed. The assessment in question as revised is hereby confirmed.