

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D136/98

Profits Tax – acquisition and sale of property – intention of purchaser at time of acquisition – burden of proof on purchaser – whether tax chargeable on the profits of sale.

Panel: Ronny Wong fook Hum SC (chairman), Herman Fung Man Hei and Paul Ng Kam Yuen.

Date of hearing: 16 November 1998.

Date of decision: 18 December 1998.

Ms A (First Taxpayer) and Ms B (Second Taxpayer) completed the purchase of a property (Property 1) on 15 March 1991. It was allegedly purchased with the intention that it be their joint residence. Ms A, a civil servant at the time, was living in Property 2, which she eventually sold on 4 September 1994. At the same time, Ms B was living with her family at their family home. Property 1 was left 'vacant until sold' and was eventually sold on 14 April 1992. The Commissioner determined that Ms A and Ms B ought to have paid profits tax on the gains derived from the sale of Property 1. Ms A and Ms B appealed. They averred that the property had been purchased for their own use as a future residence and they had not intended to speculate on the market when they purchased it.

Held:

- (1) It was for the Ms A and Ms B to prove that the property was acquired as a future residence. The stated intention of the taxpayers was not decisive but must be viewed in the light of all the surrounding facts presented to the Board (All Best Wishes Limited v CIR 3 HKTC 750 per Mortimer J, followed);
- (2) The intention of each participant in the purchase of a property might, on occasion, have to be separately assessed (D77/96, IRBRD, vol 11, 698);
- (3) Upon considering the evidence as a whole, the Board doubted the assertion made by Ms A as to her intention at the material time. Ms A had asserted that her disposition of Property 1 depended upon the state of the property market. Accordingly the Board did not accept that Ms A had intended all along to reside in the property as a future residence. Hence, she failed to discharge her onus;
- (4) The Board, however, accepted the assertions made by Ms B, as to her intention at the material time. Ms B had been living at home. She had been

INLAND REVENUE BOARD OF REVIEW DECISIONS

anxious to move out for a long time. Once Property 1 was sold, she immediately purchased Property 3 in which she has resided ever since. There were indications that she had not bought into Property 1 simply for investment purposes.

Appeal dismissed for the first taxpayer and allowed for the second taxpayer.

Case refereed to:

D77/96, IRBRD, vol 11, 698
All Best Wishes Limited v CIR 3 HKTC 750

Fung Chi Keung for the Commissioner of Inland Revenue.
Taxpayers in person.

Decision:

Background of this appeal

1. This is an appeal by the Taxpayers ['Ms A (the First Taxpayer) and Ms B (the Second Taxpayer)'] against the assessment by the Revenue of profits tax on the gains they derived from the disposition of a flat in District C ['Property 1'].
2. Ms A and Ms B jointly purchased Property 1 on 15 March 1991 for \$1,160,112. They paid initial deposits of \$116,011.2 (10% of the purchase price) and they financed the balance of \$1,044,100.8 via an equitable mortgage in favour of a credit company repayable by 240 monthly instalments of \$10,075 each.
3. In March 1991, Ms A was working with the Government earning a basic salary of \$20,165 per month. She was then residing in a flat in District D ['Property 2']. Property 2 was mortgaged by her in favour of a credit company to secure initially a loan of \$320,760. By July 1991, Ms A became eligible for home purchase allowance ['HPA']. In anticipation of this HPA, Ms A further charged Property 2 in May 1991 for an additional loan of \$638,276.38. The consolidated loan was repayable by 120 monthly instalments of \$11,350 each. She placed the amount raised from this additional loan on foreign currency deposits. Her HPA for July 1991 was \$6,820. This was raised to \$6,850 for the subsequent months.
4. At that juncture Ms B was living with her parents, brother and sister-in-law in District E. She was earning \$11,000 per month.
5. Ms A was admitted in September 1991 by a university for its legal course. Ms A was on no pay leave as from December 1991. Her HPA was likewise suspended. She

INLAND REVENUE BOARD OF REVIEW DECISIONS

resumed working with the Government in June 1992 before she resigned and became a trainee solicitor on 13 July 1992.

6. Ms A and Ms B obtained vacant possession of Property 1 on 11 January 1992. They took an assignment of that flat on 19 February 1992 and incurred \$53,597 in stamp duty and legal charges.

7. By a provisional agreement for sale and purchase dated 8 March 1993, Ms A and Ms B disposed of their interests in Property 1 for \$1,970,000. The sale was completed on 14 April 1992.

8. On 6 March 1993, Ms B and Her brother jointly purchased a flat in District F [‘Property 3’] for \$1,483,000. Ms B has held this property ever since.

9. Ms A became a solicitor in June 1994. By an agreement dated 2 August 1994, she purchased a flat in District F for \$3,400,000. This was followed by her sale of Property 2 on 4 September 1994. She moved from District F to District G in about August 1997.

Correspondence with the Revenue

10. In response to inquiries, Ms A informed the Revenue that Property 1 was purchased with the intention that it be the residence of Ms B and herself. She further intended to rent out Property 2. After obtaining possession from the developer on 11 January 1992, Property 1 was left ‘vacant until sold’. She further explained that ‘I ceased work in December 1991 and studied full time in the university for about one year. I had no income and decided that I should not be burdened with the mortgage repayments in respect of the captioned property. The Property was therefore sold.’

11. In relation to the additional loan of \$628,276.36 raised by the further charge on Property 2, Ms A explained that she did not commence repaying that loan until 28 August 1992. The delay was attributable to the fact that ‘the foreign currency deposits were yielding quite good returns.’

Oral evidence of Ms A

12. In about March 1991, she and Ms B noticed the advertisement for sale of units in the private housing estate where Property 1 situated. They inspected the site and found the same satisfactory. Ms B could not afford to purchase an entire unit. They therefore decided to co-operate in the purchase.

13. At the time of purchase, she was thinking of investment and proper management of her assets. If necessary she would reside in Property 1 as the surroundings there were satisfactory.

INLAND REVENUE BOARD OF REVIEW DECISIONS

14. She applied for the legal course in about June 1991 after completing a part time degree course. When she went on no pay leave at the end of 1991, instalment payments for Property 1 and Property 2 became burdensome.

15. After obtaining possession of Property 1 the two of them were very interested in the then worth of the flat. They contracted estate agents who had been sounding them out for sale of the unit. As she was out of work, she raised the issue of sale with Ms B. Ms B did not object and the unit was sold.

16. They did not purchase any electrical appliance for use in Property 1. They also had no decoration done to that flat. After obtaining possession, it was used as a holiday home. When confronted with the assertion in correspondence that Property 1 was purchased with the intention of using the same as their joint residence, Ms A explained that it was possible that the flat would be used as their residence but this was dependant upon the market price and her discussion with Ms B.

17. She was on very good terms with Ms B. They had been friends for well over 20 years.

18. She places heavy reliance on the decision of this Board in D77/96, IRBRD, vol 11, 698.

Oral evidence of Ms B

19. She had been residing with her parents and her brother prior to the purchase. She was anxious to acquire a piece of property for her own residence.

20. After their purchase of Property 1 its price continued to rise. They refrained from selling the unit as they intended to reside in it.

21. They eventually decided to sell Property 1 as Ms A was out of work and Ms A could not afford instalment payments on two flats.

22. She was very anxious to acquire alternative unit after sale of Property 1. Flats were then very expensive. She eventually opted for Property 3. She has held that ever since.

23. After disposal of Property 1, she had no further discussion with Ms A on the possibility of sharing another flat. Her accommodation ceased to be a pressing issue as her brother moved out.

The law

24. The principles are clear. We have to ascertain the intention of Ms A and Ms B at the time when Property 1 was purchased. We have to be satisfied that their intention was

INLAND REVENUE BOARD OF REVIEW DECISIONS

to purchase the same as their residence and such intention is on the evidence ‘genuinely held, realistic and realisable’.

25. As pointed out by Mortimer J (as her then was) in All Best Wishes Limited v CIR 3 HKTC 750:

‘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.’

26. In D77/96 the property in question was purchased in the name of X, Y and Z. X wanted to acquire this property as his residence. He approached Y and Z for their financial assistance. Y and Z stated that they would not simply lend X the money. They were prepared to take a share in the property. It was agreed between X, Y and Z that, subject to unforeseen circumstances, the interest of Y and Z in the property would be purchased by X at the prevailing market price as at the time of completion. The property was sold in a surging property market because X could not otherwise repay the loans. 5 months later X purchased another flat as his residence. Only X appeared before the Board of Review. The Board took the view that if X was not carrying on a trade, it must follow that X, Y and Z were not in partnership. The Board left open the question of Y and Z’s liabilities. In relation to the liability of X, the Board accepted his contention that he went into the purchase with the view of using the property as his residence. His appeal was therefore allowed. The relevance of this case lies in the recognition by the Board that the intention of each participant in the purchase might have to be separately assessed.

Our decision

27. We find on the evidence that there was no joint plan between Ms A and Ms B at the time of purchase of Property 1 to use the same as their residence. Ms A’s evidence makes this abundantly clear. Whilst Ms A would not rule out the possibility of using Property 1 as the parties’ joint residence, such user was dependant on the state of the market. It is therefore difficult to accept that there was a common objective between them towards that end. We further reject the evidence that the premises was used as the parties’ holiday flat after obtaining possession.

28. On Ms A’s own evidence she had no settled long term objective at the time of the purchase. She had her own flat and there was no compelling reason for her to move. Her reliance on D77/96 seems to suggest that she is equating her position with that of Y and Z in that case, namely, as financier in support of Ms B’s purchase of Ms B’s residence. As pointed out above, the positions of Y and Z were left open in D77/96. There is no evidence in support of a similar agreement as the one proved in D77/96.

29. We are not persuaded by Ms A’s reasons leading to the sale of the unit. We find her evidence on approaches made by estate agents nearer to the truth.

INLAND REVENUE BOARD OF REVIEW DECISIONS

30. We hold that Ms A has failed to discharge her onus of proof. We are of the view that she should be assessed on 50% of the profits arising from disposal of Property 1.

31. Ms A's evidence prompts us to approach Ms B's case with caution. We are however convinced that she did enter into this venture with a view of making provisions for herself. She was then residing in District E with her parents, her brother and her sister in law. Her anxiety to live apart is understandable. After selling Property 1, she bought Property 3 at first available opportunity. She has held that flat ever since. Her position is similar to that of X in D77/96. We therefore allow her appeal and discharge the assessment on her pertaining to 50% of the profit arising from the disposal of Property 1.