

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D146/99

**Profits Tax** – whether gain on sale of property capital or trade in nature.

Panel: Ronny Wong Fook Hum SC (chairman), Karl Kwok Chi Leung and Duffy Wong Chun Nam.

Date of hearing: 9 February 2000.

Date of decision: 23 March 2000.

The taxpayers are husband and wife. By a provisional agreement dated 14 December 1996, the wife purchased a unit (Property 4) at \$7,670,000. A total of \$767,000 had to be paid by 3 January 1997 leaving the balance of \$6,903,000 payable on completion on 31 January 1997. By a provisional agreement dated 29 December 1996, the taxpayers purchased another unit (Property 5) at \$5,820,000. A total of \$582,000 had to be paid by 16 January 1997 leaving the balance of \$5,238,000 payable on completion on 1 April 1997.

The taxpayers completed the purchase of Property 4 on 31 January 1997 with the aid of a bank loan of \$5,370,000. On the same day, they sold Property 4 for \$8,100,000. The sale was completed on 3 July 1997. By a provisional agreement dated 16 February 1997, the taxpayers sold Property 5 for \$6,350,000. The sale was completed on 1 April 1997.

By a determination dated 24 September 1999, the Commissioner of Inland Revenue took the view that Properties 4 and 5 were purchased by the taxpayers with a view for resale for profit and thus assessable to tax.

#### **Held :**

1. Property 4 was purchased on 14 December 1996 for \$7,670,000 and sold on 31 January 1997 for \$8,100,000. Property 5 was purchased on 29 December 1996 for \$5,820,000 and sold on 16 February 1997 for \$6,350,000. These are strong pointers towards an intention to trade on the part of the taxpayers.
2. Taking all the circumstances into account, the Board did not accept the taxpayers' case that they purchased Property 5 in order to split up their family as a result of their difficulties with their son was 'genuinely held, realistic and realisable'.

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3. As to Property 4, the Board found that there was a desire to sell Property 4 when Property 5 was purchased and Property 4 was held for less than two months. These are also inconsistent with the original alleged intention of splitting the family into two flats. Thus the taxpayers also failed to discharge their onus of proof in relation to Property 4.

### **Appeal dismissed.**

Leung Wing Chi for the Commissioner of Inland Revenue.

Taxpayer in person.

### **Decision:**

### **Background**

1. The Taxpayers, Mr and Mrs A, are husband and wife. They have four children including a second son [ ' Mr B ' ] born on 25 September 1978. Mr B unfortunately is an autistic child with behavioural problems such as frequent rocking, knocking, jumping and noise making.
2. On 22 April 1985, Mr A acquired a unit in District C [ ' Property 1 ' ]. Property 1 has a floor area of 1,600 square feet. It has been used as the family' s residence ever since.
3. On 24 January 1994, the Taxpayers purchased a unit in District D [ ' Property 2 ' ]. Property 2 has a floor area of 900 square feet. The Taxpayers used it as their holiday home.
4. On 18 March 1994, the Taxpayers purchased a further flat in District D [ ' Property 3 ' ] at \$3,460,000. It has a floor area of 850 square feet. The family used it when it was not let out to tenants. The last letting was by a tenancy agreement dated 2 April 1996 for two years up to 6 April 1998. This tenancy was however terminated on 16 January 1997 by a supplemental agreement dated 4 January 1997.
5. Mr B was admitted into a special school in District E on 6 June 1994. We have before us various reports on his performance. It is obvious from those reports that his performance was erratic and his supervision demands great patience and understanding.
6. By a provisional agreement dated 14 December 1996, Mrs A purchased via a property agency [ ' Company F ' ] a unit in Private Housing Estate G in District H [ ' Property 4 ' ] at \$7,670,000. A total of \$767,000 had to be paid by 3 January 1997 leaving the balance of \$6,903,000 payable on completion on 31 January 1997. Property 4 has a gross floor area of \$1,078 square feet.

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7. By a quotation dated 15 December 1996, Company I quoted for renovation works at Property 4. The quotation at \$104,400 covered painting the whole premises; new wall papers for the whole premises; new floor polish for the whole premises; new sockets and new taps in the washrooms. By a receipt dated 29 January 1997, Company I acknowledged payment of \$104,400.

8. There were apparently complaints from the owner of the unit immediately below Property 4 concerning the heavy waterstains on his ceilings and water leakages from Property 4. The matter was investigated by an agent of Company F in the company of Mr J of Company I. The report of the agent dated 18 December 1996 confirmed water seepage.

9. According to computer records maintained by Company F, Mrs A indicated she may consider selling Property 4 on 29 December 1996. She was asking for \$8,300,000 with 1% commission to the agent. The asking price fluctuated as follows:

<b>Date</b>	<b>Asking price</b>
	\$
29-12-1996	8,300,000
15-1-1997	8,200,000
18-1-1997	8,100,000
19-1-1997	8,380,000
21-1-1997	8,100,000
25-1-1997	8,600,000
29-1-1997	8,380,000
31-1-1997	8,600,000

10. By a provisional agreement dated 29 December 1996, the Taxpayers purchased another unit in Private Housing Estate G in District H [ ' Property 5 ' ] at \$5,820,000. A total of \$582,000 had to be paid by 16 January 1997 leaving the balance of \$5,238,000 payable on completion on 1 April 1997.

11. By an agreement dated 3 January 1997, the Taxpayers sold Property 3 for \$3,398,000. That sale was completed on 18 March 1997.

12. According to the computer records maintained by Company F, Property 5 was offered for sale at \$6,500,000 with 1% commission on 4 January 1997. The asking price varied as follows:

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<b>Date</b>	<b>Asking price</b>
	\$
4-1-1997	6,500,000
13-1-1997	6,400,000
17-1-1997	6,250,000
31-1-1997	6,300,000
6-2-1997	Suspended for sale
11-2-1997	6,400,000
16-2-1997	6,350,000

13. The Taxpayers completed the purchase of Property 4 on 31 January 1997 with the aid of a bank loan of \$5,370,000. On the same day, they sold Property 4 for \$8,600,000. The sale was completed on 3 July 1997.

14. By a provisional agreement dated 16 February 1997, the Taxpayers sold Property 5 for \$6,350,000. The sale was completed on 1 April 1997.

15. By a determination dated 24 September 1999, the Commissioner of Inland Revenue took the view that Property 4 and Property 5 were purchased by the Taxpayers with a view of resale for profits and the profits derived therefrom should be assessable to tax. The Commissioner further refused to allow such profits to be set-off against the loss arising from disposal of Property 3 as Property 3 was the Taxpayers' capital asset.

16. The Taxpayers appealed against that determination. At the hearing before us, all the arguments centred on the taxability of profits arising from Property 4 and Property 5. No argument was advanced in relation to Property 3.

### **Case of the Taxpayers as per the correspondence**

17. By letter dated 25 June 1998, Messrs John Wu & Co, then representative of the Taxpayers, explained to the assessor that:

- (a) The Taxpayers intended to purchase Property 4 and Property 5 'as a replacement of [Property 3].'
- (b) 'Our client planned to split the family members into two-groups. Mother-in-law together with grown up daughter to reside at [Property 5] and husband, wife and three other children to reside at [Property 4]. During January 1997, renovation work of small scale was carried out for [Property 4], but discovered serious leakage problem which require more expenses for improvement.'

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Complaints received from flat below re leakage and damages. Our client tried to explore rental market, but rental return was not attractive and therefore decided to sell the property ...’

- (c) Due to sale of [Property 4], the plan of splitting the family cannot be achieved. Also similar leakage problem was envisaged for [Property 5] which again will incur extra renovation cost. As a result, our client also disposed [Property 5] ...’

18. Mrs A further explained to the assessor that:

- (a) ‘ The key reasons for having to split up the family are: crowding, generation gap (communication problem) and to separate my autistic son from the other children.’
- (b) ‘ The removal of a big and complicated family like ours is not an easy and simple task. We had a brainstorming and painstaking process in deciding to move into or to give up [Property 4 and Property 5] after discovering the potential nuisance in the structural drainage and leakage system and the huge repair/maintenance cost. Ultimately, to avoid undue and unnecessary disturbance to my mother-in-law and my children, we decided to cancel the idea of moving.’
- (c) ‘ We have been looking for some other flats, however, owing to dramatic changes in the economy and the property markets we have not reached any decision. But we are still in need of splitting up the family into two separate residential units.’

### **The hearing before us**

19. Mrs A appeared with Mr B. We have no doubt that Mr B was introduced so that we can have first hand experience on the problems that he can generate. Mr B was initially permitted to sit in our Chambers. The commotion that he created left us with no choice but to invite him to wait outside Chambers. A relative then took him to McDonald. His return was marked by repeated banging of various walls in the Board of Review. We can appreciate the pressure on the Taxpayers’ family and the strength required on the part of the Taxpayers to care for Mr B.

20. Mrs A gave sworn testimony. The following are salient features of her evidence :

- (a) Mr B has all along been under the care of a university’ s psychiatric unit. In the years 1995-96, she refused to use drugs to control Mr B’ s behaviour for fear of unknown side effects. Mr B’ s position was very unstable. His conditions took

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a turn for the worse in 1996-97. She commenced using drugs in 1997. Mr B's conditions improved. There is now a chance of Mr B being admitted to a dormitory in a year to two years time.

- (b) There are three rooms in Property 1. Her mother-in-law occupies one room with her eldest daughter who is now working with a bank. Mr A sleeps with Mr B in one room. She shares the other room with her two younger children.
- (c) Property 4 was bought with vacant possession. She visited that flat twice prior to her purchase. Property 5 was tenanted. She did not have free access to that flat prior to her purchase.
- (d) It was her intention to house her mother-in-law, three children and a maid in Property 4. She would reside in Property 5 with her husband and Mr B.
- (e) She produced a further quotation from Company I dated December 1996 [ ' the Second Quotation' ] for our consideration. In respect of Property 4. Company I quoted \$206,000 for, inter alia, replacement of all pipes in the kitchen; application of a mould-preventing coating to the ceiling and replacement of kitchen cabinets and utensils. Company I offered a 5% discount if similar work be carried out at Property 5.
- (f) She was surprised by the leakages in Property 4. She thought spending \$104,400 pursuant to the 15 December 1996 quotation from Company I would cure the problems. The leakages could not be identified by causal inspection.
- (g) There were repeated complaints from downstairs neighbour of Property 4. She reckoned that similar defects would be found in Property 5.
- (h) Company F was not the only agent who approached her in relation to the subject properties. Numerous other agents were sounding her out. An agent of Company F was however most persistent. She expressed reservations as to the accuracy of Company F's computer entries but she accepted that she was interested in the market price of Property 4 and Property 5.
- (i) The Second Quotation was produced in January 1997. Mr J of Company I was assisted by another contractor.

21. At the conclusion of the hearing, with the consent of the Respondent (the Revenue), we gave leave to Mrs A to submit a written closing submission to us 7 days after the hearing. We made

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it very clear to Mrs A that her submission must be based on the evidence already adduced and we will not receive any fresh evidence from her.

22. On 18 February 2000, we received from Mrs A her closing submission together with two statements, one from an agent of Company F and the other from Company I. We are not prepared to receive these two statements in evidence. Mrs A gave no reason as to why these two statements could not have been adduced in the first place. Given the circumstances of their introduction, we are not prepared to place any weight on them even if the same be admitted in evidence.

### **Our decision**

23. Property 4 was purchased on 14 December 1996 for \$7,670,000 and sold on 31 January 1997 for \$8,100,000. Property 5 was purchased on 29 December 1996 for \$5,820,000 and sold on 16 February 1997 for \$6,350,000. These are very strong pointers towards an intention to trade on the part of the Taxpayers. The Taxpayers' case is that they wanted to split up their family as a result of their difficulties with Mr B. We have to see whether such intention is on the evidence 'genuinely held, realistic and realisable'.

24. As indicated above, we entertain no doubt that Mr B was a heavy burden on the family. However there are clear pointers in the facts before us calling for caution. First, the leakage problems surrounding Property 4 were identified on 18 December 1996. Warning bells would have sounded by then. It is difficult to see why in those circumstances the Taxpayers would have entered into an agreement on 29 December 1996 for the purchase of Property 5 whilst expressing on the same day a wish to dispose of Property 5. We appreciate the tactics commonly employed by real estate agents. However we see little room for persuasion if the intention to split the family was a determined one. After all that sort of decision is a painful one and not one lightly made. Giving every allowance for inaccuracies in the computer records of Company F, we are of the view that their computer entries do reflect a genuine desire on the part of the Taxpayers to sell Property 4 in late December 1996/early January 1997. Secondly, it is alleged that the original plan to split the family was frustrated when the Taxpayers realised the costs involved in renovating both flats. We have very little evidence as to the level of earnings of the Taxpayers at the material time. However they held Property 1, Property 2 and Property 3. They would have no difficulty in paying the price asked for in the Second Quotation in respect of both Property 4 and Property 5. Furthermore various items in the Second Quotation had no relevance to the leakage problems. If there was a genuine intention to split the family, costs would have been the least of the Taxpayers' concerns. For these reasons, we have no hesitation whatsoever in dismissing the Taxpayers' appeal in relation to Property 5.

25. We find it much more difficult to come to our decision in relation to Property 4. On the one hand, we understand the disruptive effects of Mr B's behaviour on the whole family. We

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appreciate a possible desire to provide tranquillity to some family members. On the other hand, there were only cosmetic renovations done to Property 4. There was a desire to sell that property on the same day when Property 5 was purchased. Property 4 was held for less than two months. All these are inconsistent with the original alleged intention of splitting the family into two flats. With some hesitation, we conclude that the Taxpayers also failed to discharge their onus of proof in relation to Property 4.

26. For these reasons, we dismiss the Taxpayers' appeal and confirm the assessment.