

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D16/97

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

Panel: Ronny Wong Fook Hum SC (chairman), Gregory Robert Scott Crichton and John Mark Eddleston Leese.

Dates of hearing: 17 and 18 February 1997.

Date of decision: 29 April 1997.

The taxpayer purchased the suit premises relying on representations in the sale brochure as the facilities available in the development. The taxpayer opted to pay for this purchase by monthly instalments. 14 monthly instalments were paid towards the purchase. The suit premises was sold 3 months after the taxpayer took possession and discovered that the facilities were not in line with the representations in the sale brochure.

Held:

The taxpayer had discharged his onus of proving that the purchase was for use as family home.

Appeal allowed.

Cases referred to:

All Best Wishes Ltd v CIR 3 HKTC 750

Lionel Simmons Properties Ltd v The Commissioner of Inland Revenue 53 TC 461

Yim Kwok Cheong for the Commissioner of Inland Revenue.

Taxpayer represented by his wife.

Decision:

The Background

1. The Taxpayer is an engineer working with Company A. His wife ['Mrs B'] is an employee of Company C.

INLAND REVENUE BOARD OF REVIEW DECISIONS

2. After their marriage, they lived in a 395 square feet in Flat 1 which they obtained by way of gift. After the birth of their daughter in September 1982, the family moved into Flat 2. Mrs B gave birth to their son on 7 May 1988.
3. By August 1988, Mrs B became entitled to Private Tenancy Allowance from Company C. She entered into a tenancy dated 9 July 1988 in respect of Flat 3 for a term of 2 years from 1 August 1988 to 31 July 1990 at a monthly rental of \$10,000. The total floor area of Flat 3 was 900 square feet. There were 3 bed-rooms of 90, 80 and 56 square feet respectively. By an application dated 13 July 1988, Mrs B applied to Company C for Private Tenancy Allowance in respect of her occupation of Flat 3.
4. The tenancy in Flat 3 was renewed by a second tenancy agreement dated 30 June 1990 for 2 years from 1 August 1990 to 31 July 1992 at a monthly rental of \$12,000. By an application dated 19 June 1990, Mrs B again applied to Company C for Private Tenancy Allowance in respect of this tenancy.
5. In August 1990, the Taxpayer entered into an agreement for the purchase of Flat 4 for \$1,555,625.
6. According to the sales brochure in respect of Flat 4:
 - a. The gross area of the House was 1,380 square feet. Its saleable area was 1,190 square feet. There was a roof area of 595 square feet together with a garden area of 1,680 square feet.
 - b. Recreational facilities of the entire complex included 'A resident's club with tennis courts, billiard room, games room and a swimming pool'.
 - c. The complex would include a convenience store and a shuttle bus service.
7. The sale brochure further outlined 2 methods for payment of the purchase:
 - a. Cash payment and immediate mortgage with 5% discount: This called for an initial deposit of \$20,000 upon signing of a provisional agreement; 10% within 5 days upon signing of the sale and purchase agreement and the balance within 10 days through an equitable mortgage loan.
 - b. Instalment payment with no discount: This called for an initial deposit of \$20,000 upon signing of a provisional agreement; 10% within 5 days upon signing of the sale and purchase agreement; 5% on or before 31 October 1990; 5% on or before 31 January 1991 and the balance within 14 days of the issuance of the occupation permit.
8. The Taxpayer opted for the first method of payment. An initial deposit of \$135,562.5 was paid on 10 August 1990 with the balance of \$1,400,000 by 240 monthly instalments. The initial deposit was met by a withdrawal of \$160,000 from the joint savings

INLAND REVENUE BOARD OF REVIEW DECISIONS

account of the couple with Bank D. The balance was financed by a mortgage loan of \$1,400,000 extended by Bank E in favour of the Taxpayer and guaranteed by Mrs B. The loan was repayable by monthly instalments of \$14,930.02 each. The rate of interest was calculated on the basis that Flat 4 would be owner occupier. A total of 14 monthly instalments were paid by the Taxpayer from the family's savings before Flat 4 was disposed of as referred to below.

9. The purchase of Flat 4 was duly completed in April 1991. By a series of receipts dated 4 May 1991, the Taxpayer paid the developer in respect of decoration charges, water meter, electricity meter and deposit in respect of management fees.

10. By a letter of authorization dated 31 August 1991, the Taxpayer authorised Agency F to sell Flat 4 at \$2,600,000. By an agreement dated 12 October 1991, the Taxpayer succeeded in disposing Flat 4 at the price so designated.

11. On 18 March 1992, the Taxpayer and his wife entered into an agreement for the purchase of Flat 5 at \$2,850,000. The couple paid an initial deposit of \$250,000 and financed the balanced by means of a mortgage loan of \$1,710,000 from Bank G with monthly repayment at \$22,835.2.

12. Mrs B notified the landlord of Flat 3 on 29 June 1992 that the tenancy would not be renewed upon its expiry on 31 July 1992. She further applied on 1 July 1992 to Company C for financial assistance to purchase Flat 5 under Company C's Home Purchase Assistance Scheme. Company C acceded to her application. From 31 August 1992, a monthly credit of \$12,300 was made in favour of the couple.

13. Flat 5 is of an area of 1,250 square feet. The Taxpayer and his family have been residing in Flat 5 ever since.

14. The issue before us is whether the profits made by the Taxpayer on his disposal of Flat 4 is chargeable to profits tax.

Evidence on behalf of the Taxpayer

15. The appeal was handled throughout by Mrs B with the assistance of the Taxpayer.

16. Mrs B told us that it was anticipated that she would be entitled to assistance under the Home Purchase Assistance Scheme of Company C. She and her husband therefore decided to locate a suitable property for purchase under that Scheme. They saw an advertisement in respect of Flat 4. They drove to the site and liked the environment as the development is near the countryside. They were attracted by the facilities described in the sales brochure and in particular the reference to the convenience store and the shuttle bus service.

INLAND REVENUE BOARD OF REVIEW DECISIONS

17. She did not put her name down as one of the joint owners ‘as there is no secret between myself and my husband’. She could see no obstacle in adding her name as one of the co-owners for the purpose of the Home Assistance Scheme.

18. After completion of the purchase on issuance of the occupation permit, the family stayed in Flat 4 during alternative weekends. They did not stay in the premises overnight. The house was not decorated. She only purchased a few chairs, mattresses but no electrical appliances and the premises was used as a ‘leisure house type of facility’. At this juncture she found out that the complex did not have any convenience store. There was no clubhouse or swimming pool. She was also told by the management of the complex that the shuttle bus service would not be available in the short term. The couple therefore decide to sell Flat 4.

19. There is no clubhouse or other recreational facilities in Flat 5. However the flat is near a commercial complex for ready access to daily necessities.

20. Mrs B further explained that one of the reasons for the purchase of Flat 4 is the family’s love of outdoor life. She seeks to demonstrate this by their membership with the Organic Farm. They all joined the Organic Farm after frustration of their plan to move into Flat 4.

The Statutory Provisions

21. Section 14 of the Inland Revenue Ordinance (the IRO) provides that:

‘(1) Subject to the provisions of this IRO, profits tax shall be charged ... on every person carrying on a trade, profession or business in Hong Kong in respect of the assessable profits from such trade, profession or business (excluding profits arising from the sale of capital assets)...’

22. Section 2 of the same IRO defines ‘trade’ to include ‘every adventure and concern in the nature of trade’.

23. Section 68 further provides that ‘The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant’.

24. The classic statement of the applicable principles governing this area is to be found in the judgment of Mortimer J in All Best Wishes Ltd v CIR 3 HKTC 750

*‘... Reliance is placed upon a passage of Lord Wilberforce in Lionel Simmons Properties Ltd v The Commissioner of Inland Revenue 53 TC 461 at 491 ...
The nub of it reads:*

“Trading requires an intention to trade. Normally the question to be asked is whether this intention existed at the time of the acquisition of the asset.”

INLAND REVENUE BOARD OF REVIEW DECISIONS

The Taxpayer submits that this intention, once established, is determinative of the issue ... I am unable to accept that submission quite in its entirety. I am, of course, bound by the Decision in the Simmons case, but it does not go quite as far as is submitted. This is a question of fact and the fact to be decided is defined by the Statute – was this an adventure and concern in the nature of trade? The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence ... 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...'

Arguments of the Revenue

25. The Revenue relied on the short period of ownership. It was argued that the Taxpayer held Flat 4 for less than 5 months between 20 May 1991 and 12 October 1991. We do not find much force in this submission. It is misleading to pick the 20 May 1991 date. That was the date when Flat 4 was assigned in favour of the Taxpayer. However the Taxpayer acquired his interest in August 1990. He retained this interest for well over a year before disposing of the same.

26. The Revenue pointed out that the Taxpayer did not use Flat 4 as his residence. This is demonstrated by the low electricity consumption over the material period. Very little was done to decorate the house as the family home. No attempt was made to terminate the tenancy in Flat 3. The family stayed there till expiration of the subsisting tenancy.

27. The Revenue further argued that Mrs B was at all material times entitled to House Allowances under the regulations of 'Company C'. The Revenue further asserted that such Allowances would not be available to support the purchase of Flat 4 as the same was acquired in the Taxpayer's sole name. We find it difficult to reconcile this submission with Regulation 18 of Company C's 'Regulations Governing the Grant of Private Tenancy Allowances and House Allowances' which provides:

'Appointees on local terms with a substantive monthly salary at Point 38 on the Company C Pay Scale or above, who live in accommodation which they owned themselves or which is owned by a member of their immediate family (that is, spouse, parent, brother, sister or child) or in which they reside as members of Government Built Housing Schemes may be granted a house allowance upon application'.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Our Decision

28. Our task is to ascertain the intention of the Taxpayer in August 1990. We view Mrs B's assertions in relation to the various representations in the sales brochure with caution. However given the fact that they resided in Flat 2 for quite some time, we do not regard their selection of Flat 4 nearby extraordinary.

29. The lack of any positive step to decorate Flat 4 and to terminate the tenancy in Flat 3 are strong pointers against the contention of the Taxpayer. The explanation that the family used Flat 4 during alternative weekends as a leisure house also casts doubt on the Taxpayer's original intention.

30. What weights in favour of the Taxpayer is his selection of the method of payment for Flat 4. He opted for the first of the 2 alternatives. He did not leave 80% of the consideration to be paid upon issuance of the occupation permit which would be highly indicative of an intention to speculate. The Taxpayer paid a total of 14 monthly instalments. No step was taken to dispose of Flat 4 until 31 August 1991 – well over 3 months after they took possession on 4 May 1991. This is consistent with the Taxpayer's case that by then they found out the inaccuracies of the representations in the sales brochure.

31. Taking all these factors into consideration, we have, with some reluctance, come to the conclusion that the Taxpayer has discharged the onus on him. We allow the appeal and set aside the assessment.