INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D18/00

Profits tax – acquisition and sale of property – intention at time of purchase – burden of proof on purchaser to establish that property purchased for long term investment.

Panel: Ronny Wong Fook Hum SC (chairman), Felix Chow Fu Kee and Winnie Kong Lai Wan.

Date of hearing: 25 March 2000.
Date of decision: 13 June 2000.

The taxpayer owned Property 1 in District H which was used as the family home. The taxpayer also owned Properties 3 and 4 which were rented out to tenants. As a result of a proposed redevelopment in District D, the taxpayer was offered (by way of internal sale through his company) to and did purchase Property 2 in District D. He stated that he had the intention to reside there but did not do so because of various problems that later arose. He eventually sold Property 2 when the proposed redevelopment did not materialise.

Held:

1. It was for the taxpayer to prove that Property 2 was acquired as a future residence. The stated intention of the taxpayer was not decisive but must be viewed in the light of all the facts presented to the Board (All Best Wishes Limited v CIR 3 HKTC 750, 771 per Mortimer J followed).

2. There was little evidence to show an intention on the part of the taxpayer to move to Property 2. Further, there were many factors pointing towards the taxpayer having purchased the said property not for his own use, namely the location, view and the very slim chance of the redevelopment going ahead as at the time of purchase. Moreover, the taxpayer' s roots were always in District H and it was more a tenuous wish than a firm intention to move to District D.

3. The taxpayer had failed to discharge his burden.

Appeal dismissed.

Case referred to :

All Best Wishes Ltd v CIR 3 HKTC 750

Wong Kuen Fai for the Commissioner of Inland Revenue.
Neil Charke Thomson instructed by Messrs Hui & Lam for the taxpayer.

Decision:

Background

1. The Taxpayer is a married man. At all material times, he resided in Property 1 with his wife, their son and a maid. The area of Property 1 is about 930 square feet. The Taxpayer purchased Property 1 in August 1991. That purchase was financed in part by a mortgage loan from Finance Company X repayable by monthly instalments of $25,086.40 each.

2. From 1 May 1988, the Taxpayer worked as the bus engineering manager in the bus division of Company A. Before April 1997, the bus division and the rail division were two independent divisions of Company A. Mr B, general manager (bus), was the division head of the bus division stationed in Company A' s Building in District C. The then bus division had two depots, one in District C and the other in District D.

3. For the period between March 1987 and October 1990, the Taxpayer' s work place was located at Company A' s building in District C. From about November 1990, the Taxpayer switched his work place to the bus depot in District D which was part of the larger rail depot complex [' the District D Depot'].

4. On 20 December 1994, Company A sought to engage Company E as its consultant for redevelopment of the District D Depot. The District D Depot occupied only 39,208 square metres out of a total gross floor area of 139,673 square metres permissible for its site. It was then envisaged that the re-development would meet the requirements of the rail division and the bus division. However the proposed re-development did not have Governmental support. According to a memo of Company A dated 15 January 1997, ' It appears that the consensus of opinion is that this project is a "non-starter"' . According to a further memo of Company A dated 22 January 1997, the redevelopment project ' commenced in June 1988 and ..have been going round in a circle ever since' . Company A announced in 1998 that the redevelopment would not be pursued before 2004.

5. In the meantime, Company A re-structured its bus division. With effect from 1 April 1997, the bus division was downgraded as a department and put under the rail division. The bus department was further re-structured on 1 May 1998. Mr B left Company A on 30 April 1998.

6. This appeal relates to Property 2 at Housing Estate F. Housing Estate F is a development located opposite a race course. Company A developed Housing Estate F in conjunction with a property developer. There are altogether ten blocks in the development with 33 to 40 storeys per block.

7. By notice dated 15 April 1996, Company A informed its staff members that 64 units of Housing Estate F would be offered for internal sales to Company A employees. On 23 April 1996, a newspaper carried a report alleging that some Company A staff had made private sales deals with property agents in respect of those flats in Housing Estate F intended for internal sales. By notice dated 25 April 1996, Company A warned its staff that applicants for the 64 units should be end users/owner occupiers. The applicants were further warned that there could be no transfer or change of name prior to either the certificate of compliance or consent to assign.

8. On 6 May 1996, the Taxpayer submitted an application form for one of the 64 units. Only 38 out of a total of 3,000 staff members of Company A submitted such application. Out of the 64 units offered for internal sale, only 32 units face the race course. The Taxpayer was however last in the line of selection.

9. By a memorandum dated 14 May 1996, the Taxpayer acquired Property 2 for $6,789,800. The purchase was financed in part by a loan of $4,752,860 extended by a bank repayable by 240 monthly instalments of $42,001.53.

10. Occupation permit in respect of Property 2 was issued on 23 December 1996. Property 2 was assigned in favour of the Taxpayer on 3 May 1997. The Taxpayer took possession of Property 2 on the same day. He claimed that he only discovered then that Blocks 9 and 10 were so close to each other that the view of the race course from Property 2 was substantially blocked by Block 10. He further noticed a number of defects in Property 2. He submitted a defect list to the developer for remedial action on 4 May 1997. Remedial works by the developer and its sub-contractor allegedly failed to remove uneven water patches on the walls of Property 2. Hundreds of tiny bugs were said to be found on the walls. The Taxpayer asserted that he received advice from his brother, a chartered civil and structural engineer experienced in residential developments, that the water defects were irremediable.

11. By a provisional agreement for sale and purchase dated 25 June 1997, the Taxpayer sold Property 2 for $14,300,000. The issue for our determination is whether the Taxpayer is liable for profits tax in respect of his gains arising from this disposition of Property 2.

Case of the Taxpayer

12. The Taxpayer maintains that Property 2 was acquired with the view of using the same as his residence. According to his response to the Revenue' s questionnaire dated 3 June 1998, two factors prompted the purchase. First, he was then anticipating that consequential upon redevelopment of the District D Depot he would have to move his work place from District D to District C. Residence in Property 2 would entail savings of travelling time. Secondly, he wanted to upgrade the size of his residence from 930 square feet (Property 1) to 1,200 square feet (Property 2).

13. The following reasons led to his sale of Property 2 :

(a) Imperfect conditions of Property 2 : Apart from the defects referred to in paragraph 10 above, the view from Property 2 ' was not as attractive as I imagined; part of the race course view was blocked by the blocks of flats in front' .

(b) Unwillingness of the family members to move : The encounter of the Taxpayer' s wife with the tiny bugs on the walls in Property 2 was less than pleasant. Their only son was reluctant to leave the primary school where he was then studying. Their son had consistently excelled in that school and he was reluctant to leave his friends there.

(c) The opening of the Western Harbour Crossing in April 1997 : Travelling time from Property 1 to the District D Depot was reduced from 50 minutes to 30 minutes. There was however no reduction in travelling time for the Taxpayer' s wife who was working in another district.

Oral evidence on behalf of the Taxpayer

14. The Taxpayer and his wife gave evidence in support of their case outlined above. The Taxpayer admitted in evidence ownership of two other properties. The first is Property 3 which the couple acquired on 30 June 1993. The purchase of Property 3 was financed in part by a loan of $5,000,000 from Finance Company Y. At all material times, they rented out Property 3 in favour of various tenants. The second is Property 4 which the Taxpayer acquired on 30 December 1993 for $6,059,775 with the aid of a $5,450,000 loan from Finance Company Z repayable by 180 monthly instalments of $52,872.60 each. Property 4 was also let out to tenants. In May 1996, the Taxpayer and his wife were earning $85,560 and $71,870 respectively a month. With the rentals from Property 3 and Property 4, there is no doubt that they could finance the purchase of Property 2 on top of Property 3 and Property 4.

15. The Taxpayer placed before us a statement from Mr B. Mr B pointed out the Taxpayer was expected to be relocated to another office as a result of the proposed

redevelopment of the District D Depot and the most likely place of relocation was Company A' s headquarters in District C where Mr B and the bus traffic manager (the Taxpayer' s peers) were located. As Mr B is no longer residing in Hong Kong, he was not cross examined in relation to his statement.

16. The Taxpayer also called Ms G, general manager – human resources of Company A. In her statement dated 18 February 2000, Ms G pointed out that there was reasonable expectation that the Taxpayer would be relocated to another office if the redevelopment of the District D Depot was implemented. This would most likely be the headquarters in District C where Mr B and the bus traffic manager were located. Ms G however pointed out in cross examination that the Taxpayer' s re-location would depend on the feasibility study pertaining to the District D Depot.

The applicable principles

17. The principles are clear. We have to ascertain the intention of the Taxpayer when Property 2 was purchased. We have to be satisfied that the Taxpayer' s intention was to purchase the same as his residence and such intention is on the evidence ' genuinely held, realistic and realisable' .

18. As pointed out by Mortier J (as he 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.'*

Our decision

19. The Taxpayer and his wife did not have a track record of property trading. Property 1 was purchased as the family' s residence and Property 3 as well as Property 4 were let out to tenants. The Taxpayer and his wife were in a financial position to support the purchase of Property 2.

20. There is however little evidence to suggest that the Taxpayer made any real attempt to move to Property 2. The Taxpayer' s son was then studying in a primary school located in District H. According to his school reports, he was making good progress in the school. He had been with that school since 1994. With his sense of attachment to this school, we find it surprising that the issue of the education of the Taxpayer' s son was not addressed until sometime in May 1997 when the Taxpayer allegedly made inquiries about schools in District C. Giving every allowance for his son' s performance, we are of the view that the Taxpayer' s belated attempt to address this issue is inconsistent with a firm intention to move to Property 2.

21. In relation to the various reasons furnished by the Taxpayer leading to his decision to sell Property 2, we do not derive great assistance from them in assessing the Taxpayer' s intention.

(a) Desirability of Property 2 : He was the last in line for flat selection. Of the 64 Units offered for internal sale, only 32 units face the race course. It should have been apparent to the Taxpayer at the time of purchase of Property 2 that Property 2 would not enjoy the full view of the race course.

(b) Defects in Property 2 : We have examined the list of defect submitted by the Taxpayer shortly after taking possessing of Property 2. The list is unexceptional. Any prudent purchaser of a multi-million unit would have compiled a like list of defects for rectification by the developer. The list per se does not demonstrate any intention to reside in Property 2. We accept the evidence that the Taxpayer' s wife did have an unpleasant encounter in relation to bugs in Property 2. The Revenue was however informed by the subsequent buyer of Property 2 that the water stains on the wall and the water leakage in the bathroom ' had been perfectly repaired by the contractor' . We are mindful of the danger in relying on untested evidence. We do not see any reason why the subsequent buyer should be untruthful in this respect.

(c) Approach for sale : The Revenue submitted for our consideration a letter from a property agent, Company I dated 22 March 2000 wherein Company I outlined negotiations pertaining to Property 2 for the period between 19 April 1997 and 25 June 1997. Property 2 was allegedly offered at $13,500,000 on 19 April 1997. The asking price progressively increased culminating in its sale at $14,300,000. This is inconsistent with the evidence of the Taxpayer that he indicated to estate agents who approached him that he was not interested in selling Property 2 as the same was intended for self-occupation. Mr Thomson, Counsel for the Taxpayer, protested strongly against the late production of the letter from Company I. We agree with his challenge. The Revenue did not launch their investigation with Company I until 16 March 2000. They did not seek to call any one from Company I to explain how they compiled the information set out in their reply of 22 March 2000. The Taxpayer is handicapped by the late production of this letter. We do not place any reliance on this letter in assessing the overall strength of the Taxpayer' s case.

(d) Opening of the Western Corridor : We accept the Revenue' s contention that given the occupation of the Taxpayer, he would have known about the availability of this route when he purchased Property 2.

22. As far as the evidence surrounding the time of the purchase is concerned :

(a) The report in the newspaper of 23 April 1996 indicates strong interest on the part of property agents in the flats offered for internal sales. The circulars of Company A were certainly intended to dampen any speculative intent. In the end only 38 out of 3,000 eligible Company A employees applied. Did the Taxpayer seize an opening for profit or did he genuinely wish to cater for a move arising from the proposed redevelopment of the District D Depot?

(b) We are of the view that the crux of this case hinges on the likelihood of that redevelopment. The history of that project commenced in June 1988. Company A engaged Company E as its consultant on 20 December 1994. Alternative option in District J was being considered at the same time. In October 1996, Company A was still pressing the Transport Department for their comments on the redevelopment proposals for the District D Project. By January 1997, the District Lands Office of District D indicated that comments from other Government Departments were not satisfactory and the proposed redevelopment was in effect dead. Company A concluded on 15 January 1997 that the project was a ' non-starter' .

(c) In these circumstances, we are of the view that the balance of probabilities is against the Taxpayer wishing to make provision for a highly tentative project which did not have Government support and which progressed not much further than reports from Company A' s own consultant. The family had its root in District H. We do not accept that the Taxpayer made a decision for change on the basis of Company A' s tenancious wish to redevelop its District D Depot.

23. For these reasons, we dismiss the Taxpayer' s appeal.