

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D18/95

Profits tax – purchase and sale of property – whether profit subject to profits tax.

Panel: Audrey Eu Yuet Mee QC (chairman), Nicholas Ian Billingham and Vincent Liang Wan Sang.

Date of hearing: 30 March 1995.

Date of decision: 17 May 1995.

The taxpayer purchased a property and shortly thereafter sold it at a profit. The taxpayer maintained that the property had been purchased for rental and self occupation purposes and there had been a change of intention. The taxpayer and her husband both gave evidence.

Held:

The evidence given by the taxpayer and her husband was accepted.

Appeal allowed.

Cases referred to:

All Best Wishes Limited v CIR 3 HKTC 750
Simmons v IRC [1980] 53 TC 461

J R Smith for the Commissioner of Inland Revenue.

Taxpayer represented by her husband.

Decision:

This is an appeal by a taxpayer in respect of the profits tax assessment raised on her for the year of assessment 1991/92. The issue is whether she should be assessed to profits tax on the gain that she derived from the purchase and sale of Flat X ('the Property').

THE FACTS

1. The following facts are not in dispute.

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2. On 25 July 1991, the Taxpayer purchased the Property for \$2,868,000.
3. On 28 or 29 September 1991, she signed a provisional sale and purchase agreement to sell the Property for \$3,380,000. The sale was completed on 11 October 1991.
4. She furnished a profits tax return for the year of assessment 1991/92 in which she offered no profits chargeable to tax. The profit on disposal was as follows:

		\$
Sale Price (Per Statement of Property Investments)		3,380,000
<u>Less: Legal Fee</u>		(11,850)
Bank charges		<u>(54,794)</u>
		3,313,356
<u>Less: Purchase Price</u>	2,868,000	
Legal Fee and Disbursement	99,630	
Brokerage	<u>28,680</u>	<u>2,996,310</u>
Profits on Disposal of Property		<u>\$317,046</u>

Attached to the profits tax return was her letter which stated:

‘... I wanted to let it for renting. However, it was not possible to be let because the flat was in the lower floor. Moreover, it faced the Eastern Corridor which had caused noise nuisance. So, I could only sell it. Later, I purchase Flat Y with the rental contract. And I will take it back for self-occupation when the rental contract terminates this year. This was only a change of investment at that time. So, there is no need to pay tax as it is only a capital gain.’

5. The assessor found that the reasons for selling were not convincing because:
 - (1) she held the Property for less than 2 months;
 - (2) no evidence was submitted to substantiate that she had tried her best to find tenants;
 - (3) she should have known the environment before purchase.

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6. By a letter dated 23 March 1994, the Taxpayer objected to the assessment. She explained the circumstances of the purchase as follows:

‘At that time, I went to see the flat only accompanied with the property agent. It was a very hot summer. The owner of the flat closed all the windows and turned on the air-conditioner. Moreover, the daughter of the owner was playing the piano. Therefore, I could not hear sounds of the vehicles and noises from the Eastern Corridor in the lower floor. Under the skilful persuasion of the property agent and moreover, there was another buyer wanted to offer the downpayment, I determined to pay their downpayment in a rush. Actually, my husband had not seen the flat yet and I did not get his agreement. Later, my husband learnt from the guard that the flat was too noisy and was in the lower floor. My husband did not agree with my decision and I was very regretful about this. Later, we wanted to rent it out. However, after thorough consideration, we thought that this flat could never be used for self-occupation in the future. Therefore, we decided to find another place and sold this flat. We found Flat Y instead, that is, the flat of my present residence. This is all the truth, which only involves changes in living environment, without any speculation. It is only a capital gain.’

7. The Commissioner considered the additional letter and confirmed the assessment on the basis of the reasons already given by the assessor.

8. The Taxpayer appealed and further clarified in a letter dated 12 October 1994 that:

‘Actually, I wanted to let it for rent or keep it for self-residence in the future. However, as the flat was on the lower floor and faced the Eastern Corridor, it was very noisy. After being vacant for a few months, the flat still could not be let out. Moreover, we did not want to keep it for self-residence any more. Besides, we needed to repay the mortgage loan of twenty thousand odd dollars each month. As the burden became heavier, we had no alternative but to dispose of it on 10 November 1991. The sale proceeds of the above-mentioned flat were used to purchase Flat Y on 12 December 1991 with the tenancy agreement. All the above was the actual situation of my change of investment at that time. After the tenant of Flat Y moved out, our family took it back for self-residence.’

THE EVIDENCE

9. The Taxpayer was represented by her husband Mr A. They both gave evidence and were cross-examined.

10. Their evidence covered the same grounds and may be summarized as follows. The Taxpayer and her husband have one son and one daughter. Prior to the purchase of the Property, the family was residing at Flat Z, the same development where the Property was

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situated. They owned the flat. Their daughter had returned from her studies, was working in Hong Kong and residing with them. They were expecting their son who was then studying in the States to return and reside with them in about 1993. They wanted to purchase a larger property so that their son could live comfortably with them upon his return. Property market was rising and they thought it prudent to purchase a suitable property, let it out for about a year or so, and use it for their own residence upon the son's return.

11. They went to see property agents and inspected a number of properties. There were occasions when they decided on a flat and offered to buy it only to find out that they were too late and the property had in the meantime been purchased by another buyer.

12. On one occasion, two agents from a property agency took the Taxpayer and her sister to see the Property which was advertised for sale. Mr A was not free and he did not accompany them. It was June and the weather was hot. The then owner of the Property had closed all the windows, turned on the air-conditioner and there was a girl playing the piano. The Taxpayer was attracted by the harbour view and the larger living room (larger than the one in her flat). There was another couple coming to view the Property. The property agents told her that if she did not make up her mind quickly, the Property would be sold to others. No doubt having the earlier disappointments in mind, she decided to buy the Property without even consulting her husband.

13. When she informed her family of the purchase, they were excited and the whole family went to see the Property. They were told by the caretaker that the Property was noisy because it was on a lower floor and faced the Eastern Corridor. On this inspection, they discovered that the flat was very noisy once the windows were open. They found the flat unpleasant. Mr A said that since they were spending \$2,000,000 to \$3,000,000 to buy a residence for themselves, they wanted a more suitable property. They asked the property agent to advertise the Property for sale or for rental.

14. So it was almost immediately after the purchase that the Taxpayer and her family decided the Property was not suitable for their purpose. The Taxpayer was asked why she did not sell the Property right away but went ahead with the completion. She explained that she did not want to lose the deposit of \$100,000 which she had already paid.

15. At the same time, they asked property agents to find them a more suitable flat. Eventually they came across Flat Y, also in the same development ('the new Property'). This was 1,447 square feet. The size of the Property was said to be 1,050 square feet or 1,179 square feet. Their existing flat was about 900 square feet. Mr A drew a sketch for the Board showing the location and direction of these flats. Their existing flat, Flat Z faces the garden and is shielded from the Eastern Corridor by the block where Flat Y is situated. Flat Y's block is in front of Flat Z's block and faces the Eastern Corridor. Flat X's block is right next to Flat Y's block and also faces the Eastern Corridor. One obvious difference between the Property and the new Property is the size. In addition, Mr A explained that the Property faces the Eastern Corridor and one cannot open the windows because it will be too noisy. The only option is to keep the windows shut and turn on the air-conditioning all the time.

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But the new Property has only one side facing the Eastern Corridor and the other side facing the garden. The living room, which is smaller, faces the Eastern Corridor and has the harbour view. The dining room, which is much larger, faces the garden and they can open those windows. Further the new Property is on a much higher floor and the traffic noise is less noticeable.

16. On 28 or 29 September 1991, the Taxpayer sold the Property. On 17 October 1991, Mr A signed a provisional sale and purchase agreement for the purchase of the new Property for \$4,380,000. They did not receive any money for all the proceeds of sale had to go towards the new purchase. The purchase was eventually completed in December 1991 in their joint names. They had some bridging financial assistance from the Taxpayer's sister. It was purchased with a sitting tenant. This suited their purpose. They collected rent and when the tenant eventually left in early 1993 they repossessed the new Property for their own use. They are still living there.

THE LAW

17. The law on this issue is well established. Mr Smith for the Revenue cited to us section 14 of the Inland Revenue Ordinance (the IRO), All Best Wishes Limited v CIR 3 HKTC 750 which quoted the well known passage in Simmons v IRC [1980] 53 TC 461. The legal principles are not in dispute.

THE DECISION

18. The Revenue does not challenge the evidence that when the Taxpayer went to look for property, she had already formed the intention with her husband to acquire a property for their eventual residence when their son would return to Hong Kong. Pending his return, the property was to be let for rental income.

19. The Commissioner's suspicion of the Taxpayer's case is understandable. Some of her letters appear to be inconsistent with one another and with the evidence. Further she and her husband had lived in the same development for some two years and should be familiar with the price, location, size and environment of the flats in that development.

20. Having seen and heard the Taxpayer and her husband, we are satisfied that the Taxpayer did set out to buy a property for their eventual self use. When she saw the Property, she thought it was suitable. She was attracted to it, she had earlier disappointments when she and her husband had taken too long to make up their minds, she felt anxious when she saw another couple coming to view the Property, on top of that the property agents were no doubt very persuasive. She decided to buy the Property without consulting the rest of the family. The mistake was soon realized but they went ahead with the purchase for fear of losing the deposit. They incurred all the legal expenses and paid the stamp duty. Their subsequent action in selling the Property as well as their existing property in order to buy the new Property is consistent with their case. It does not appear to us to make good sense for the Taxpayer and her husband to buy the Property in order to

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make a profit and then use the profit in the purchase of the new Property. It would have made much more sense to buy a suitable property in July 1991 rather than wait a few months and incur all the trouble and expense that they did.

21. Further there is no evidence that the Taxpayer and her husband have ever traded in property in Hong Kong. Like many Hong Kong couples they have been buying their own residence and upgrading it every few years, each time selling a smaller flat and buying a better or larger one. In addition, the husband also purchased a residential property in Place W in August 1991 for \$1,000,000. It has been let for rental income and is still held in the husband's name.

22. We accept the evidence given by the Taxpayer and her husband. The intention was to buy a property for letting for about a year and then for self residence upon their son's return. However the Taxpayer made a mistake in thinking the Property was suitable. They quickly sold it and bought the property they now reside in. The transaction was not one in the nature of trade and no profits tax is payable. In the circumstances, we allow the appeal.