

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D3/92

Profits tax – purchase of uncompleted flat sold at a profit – purchasers both experienced in real estate dealing – whether sale of flat a trading transaction.

Panel: T J Gregory (chairman), Raphael Chan Cheuk Yuen and David Wu Chung Shing.

Date of hearing: 26 March 1992.

Date of decision: 9 April 1992.

The taxpayers purchased an uncompleted flat which they sold shortly before completion at a profit. The profit was charged to profits tax as arising from a trading transaction. The taxpayers appealed to the Board of Review. They submitted that the flat was intended to be their joint residence but shortly before completion they found that the premises were not suitable for them. They decided to sell the premises and made a profit. The Commissioner submitted that the persons concerned both had experience in real estate trading matters and that this was one such transaction.

Held:

The Board accepted the evidence from the taxpayers that they purchased the flat intending it to be their home and that they changed their intention subsequently. The Board rejected the claim by the Commissioner that because they had previously or subsequently engaged in property trading that this meant that all purchases and sales of residential property must be trading transactions.

Appeal allowed.

Cases referred to:

Simmons v IRC 53 TC 461
D8/90, IRBRD, vol 5, 113

Yim Kwok Cheong for the Commissioner of Inland Revenue.
Taxpayers in person.

Decision:

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1. The Subject of the Appeal

The Taxpayers, Madam X and Mr Y, appealed against the assessment to profits tax of the net amount received by them as confirmors on the assignment of the residential apartment identified later in this decision as Apartment B, and refer paragraph 2.1.2 below.

2. Facts

The following facts were not in dispute:

2.1 The properties

2.1.1 'Apartment C'

2.1.1.1 On 27 May 1985 the Taxpayers contracted to purchase a one bedroom residential apartment in an oldish building known as Apartment C in Hong Kong, together with certain furniture and fixtures, at a price of \$238,000. A copy of this agreement was submitted before the Board. Part II of the first schedule identifies the Taxpayers as the purchaser, as Tenants in Common in equal shares, and gives their address as this apartment.

2.1.1.2 A copy of the Land Office Sub-Division Register shows that the assignment was dated 6 August 1985 and was registered on 4 September 1985 and that a mortgage was obtained in an amount of \$210,000.

2.1.1.3 On 23 December 1985 they assigned Apartment C at a price of \$250,000. Net of expenses, the proceeds of sale left the Taxpayers in a virtual break even situation.

2.1.1.4 The Revenue have accepted that the Taxpayers used this apartment as their residence for some part of the time when they were the owners.

2.1.1.5 The Revenue have previously accepted that the purchase and subsequent sale of this apartment was not a venture in the nature of trade.

2.1.2 'Apartment B'

2.1.2.1 This two bedroom apartment is located on an area of land in Place C of Hong Kong Island.

2.1.2.2 In August 1985 the block in which Apartment B is now located was under construction. On 2 August 1985 the Taxpayers exchanged an agreement with the person who had contracted to purchase Apartment B from M Ltd ('the first purchaser') whereunder the Taxpayers would pay the first purchaser \$2,000

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there and then and a further \$21,000 at the time the Taxpayers and M Ltd exchanged contracts for the sale and purchase of Apartment B at the price at which M Ltd had contracted to sell the apartment to the first purchaser, namely \$335,000. The overall cost of Apartment B to the Taxpayers was \$358,000. A copy of this document was submitted before the Board.

- 2.1.2.3 The agreement between the first purchaser and M Ltd was duly cancelled and an agreement entered into between M Ltd and the Taxpayers on 19 August 1985. This sale and purchase agreement required the Taxpayers to make four instalment payments, namely \$33,500 on signing of the agreement, \$16,750 on or before 31 October 1985, \$16,750 on or before 31 January 1986 and \$268,000, being the balance of the purchase price, on or before completion. A copy of this agreement was submitted before the Board.
- 2.1.2.4 The Occupation Permit for the block in which Apartment B is situated was issued on 8 September 1986.
- 2.1.2.5 On 8 October 1986 the Taxpayers contracted to sub-sell Apartment B at a price of \$429,000. In due course they joined in the assignment of this apartment from M Ltd to the sub-purchaser as confirmors and received \$94,000 of the consideration paid by the assignee.
- 2.1.2.6 It is this sum, less certain agreed expenses, which the Revenue has assessed to profits tax.
- 2.1.2.7 At no time did the Taxpayers reside in Apartment B.
- 2.1.3 'Apartment D'
- 2.1.3.1 On 28 October 1985 Madam X and her mother purchased a two-bedroom residential apartment in a newly completed building known as Apartment D in Hong Kong at a price of \$388,000.
- 2.1.3.2 On 30 December 1990 they assigned Apartment D at a price of \$793,000.
- 2.1.3.3 The Revenue have accepted that Madam X's mother used Apartment D as her residence whilst she and her daughter were the owners.
- 2.1.4 'Apartment E'
- 2.1.4.1 On 26 January 1987 one of the Taxpayers, Madam X, acquired a residential apartment in an existing building known as Apartment E in Place S at a price \$850,000.
- 2.1.4.2 As at the date of the hearing of the appeal she was still the owner of this apartment.

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- 2.1.4.3 At no time did either of the Taxpayers reside in this apartment.
- 2.1.5 ‘Apartment F’
- 2.1.5.1 On 20 July 1987 the other Taxpayer, Mr Y, acquired a residential apartment in an existing building known as Apartment F in Place S at a price of \$575,000.
- 2.1.5.2 On 4 December 1987 he assigned Apartment F at a price of \$652,000.
- 2.1.5.3 Whilst Mr Y was the owner, the Taxpayers lived in this apartment.
- 2.2 The Taxpayers
- 2.2.1 The Taxpayers are a young couple and Mr Y was thirty-three at the time of the hearing.
- 2.2.2 By 1985, when Mr Y would have been twenty-six, they had agreed to marry but not for two or three years. Nevertheless, they had not married at the time of the hearing of the appeal. A reason satisfactory to the Board was given for this.
- 2.2.3 Mr Y
- 2.2.3.1 Mr Y had taken employment with a real estate agency. For about five months in 1986 he was employed by a local real estate agency until, in August 1986, he established his own firm and that firm was in business at the time of the hearing of the appeal.
- 2.2.3.2 The Revenue produced Mr Y’s salaries tax returns for the years of assessment 1985/86 and 1986/87. The former showed a total income of \$64,045 earned from two principal employers. The latter showed a total income of \$40,054 for the first five months of this year from the firm mentioned in sub-paragraph 2.2.3.1 above.
- 2.2.3.3 Profits tax returns filed by Mr Y, as a sole proprietor of the firm for the years of assessment 1986/87, 1987/88 and 1988/89, to which the Board was referred, each disclosed a modest profit on income from commissions and the firm’s share of joint venture property ‘investment’, which he said was with respect to properties acquired for resale in a trading venture between the firm and third parties.
- 2.2.4 Madam X
- 2.2.4.1 The Board did not consider it proper to question Madam X as to her age or educational qualifications. However, she appeared to be about the same age as Mr Y.

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- 2.2.4.2 In 1985 Madam X was employed by a company which was engaged in property investment and development.
- 2.2.4.3 The Revenue produced her salaries tax returns for the years of assessment 1986/87, 1987/88 and 1988/89. The first showed a total income of \$70,719, the second a total income of \$83,329 and the third a total income of \$98,357 all earned from the employer referred to in sub-paragraph 2.2.4.2 above.
- 2.2.4.4 At the time of the hearing of the appeal Madam X was a director and shareholder of a private company, the other director and shareholder being Mr Y's sister.
- 2.2.4.5 The audited accounts attached to this company's profits tax return for the year of assessment 1988/89, which she had signed, to which the Board was referred, disclosed that the principal activity of this company was dealing in properties and that a modest profit had been made from this activity, namely \$10,889.82 after charging, inter alia, salaries and allowances and entertainment of \$33,975.30.

3. The Oral Evidence

- 3.1 Mr Y gave evidence under oath and was cross-examined by the Revenue. Madam X confirmed the evidence given by Mr Y and was cross-examined by the Revenue.
- 3.2 Mr Y confirmed the various property transactions detailed in paragraph 2.1 above and they provided the personal detail set out in paragraph 2.2 above.
- 3.3 Apartment C:
- 3.3.1 He said that Apartment C, refer paragraph 2.1.1 above, was the first flat purchased by the Taxpayers and it was purchased on the suggestion of Madam X. It was purchased because they needed somewhere to live. They effected the purchase with financial assistance from Madam X's mother.
- 3.3.2 Vacant possession was delivered in July 1985 and they move in. Confirmation of this is found from amongst the papers produced by the Revenue, including a receipt dated 13 July 1985 addressed to Mr Y at Apartment C for a bed and mattress and a majong table. This receipt includes the words 'delivery: 8.00 pm, Wednesday'. Also amongst these papers was an undated 'demand note for water deposit' from the Water Authority payable on or before 17 August 1985 and a copy of a cheque in payment dated 17 August 1985.
- 3.3.3 He said he was quite happy with Apartment C but Madam X disliked it as she considered it too small as there was only one bedroom, a second would be

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required if they had a baby, and she also said that the floor was infested with insects.

3.4 Apartment B:

3.4.1 Because of Madam X's complaints with respect to Apartment C they looked around and identified Apartment B, refer paragraph 2.1.2 above, which had two bedrooms and good facilities.

3.4.2 He said that at this time the block was in an early state of construction and they were unable to inspect the site as the road access had not been completed and inspection would not be possible. They had decided to purchase on the strength of M Ltd brochure which Madam X had shown to her boss, who was in property development, refer paragraph 2.2.4.2 above, and who had said it looked good. He said that the monthly mortgage instalments would be about \$3,000 which he described as affordable. He added that he was not familiar with this area.

3.4.3 Their decision to sell Apartment B was dictated by the noise from the MTRC trains and other operations, factors which only became apparent after they had lived near the MTRC station.

3.5 Apartment D:

3.5.1 As Apartment B would not be ready for occupation until some time in late 1986 they had to look for somewhere to move to from Apartment C and they found Apartment D, refer 2.1.3 above.

3.5.2 They had intended to live in this apartment until the flat at Apartment B became available but when Madam X's mother saw the apartment she decided she wanted to live there and, because the mother was assisting them financially, they agreed that the apartment should be assigned to Madam X and her mother.

3.5.3 The Board asked him why they looked for an apartment to buy as opposed to an apartment to rent for this period. Mr Y replied that he would have been happy to rent but that Madam X insisted on buying.

3.6 Apartments E and F:

3.6.1 Having decided to sell Apartment B they decided to purchase an apartment at Place T.

3.6.2 In January 1987 Madam X purchased Apartment E, refer paragraph 2.1.4 above.

3.6.3 In July 1987 he purchased Apartment F, refer paragraph 2.1.5 above.

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3.6.4 Unlike Apartment C and Apartment B, which they had purchased as Tenants in Common, they had chosen to buy individually although they had agreed that these apartments were jointly owned.

3.6.5 Apartment E was let and they lived in Apartment F until he sold it at the end of the year.

3.7 Personal relations:

During the period from July 1985 to the date of the hearing the Taxpayers had lived together for part of the time and with their respective families at other times. They had lived together in Apartment C between July and November 1985, in Apartment F between July and December 1987 and in another apartment owned by the lady in Block E at Place T for about two years from April 1989. The lady had sold this apartment in October 1991.

3.8 Place U:

They had recently completed the purchase of an apartment at Place U and when the decoration had been completed they would live there.

4. Other Evidence

4.1 In addition to the documents attached to the Commissioner's determination, dated 9 December 1991, the Revenue produced a folder to the Board containing the documents previously referred to and the sale and purchase agreements relating to Apartment B. The Revenue produced separately the profits tax return of the company referred to in paragraphs 2.2.4.4 and 2.2.4.5 above.

4.2 In this folder there were copies of three letters, two of which, dated 14 February 1988 and 19 September 1989, were signed by the Taxpayers and the other, dated 22 June 1990, was signed by Mr Y. These letters were produced as they contained different explanations for the sale of Apartment B. In February 1988 and September 1989 the reason was noise from aeroplanes. In June 1990 the reason was noise generally. In his submission, the representative of the Revenue drew the attention of the Board to inconsistent statements in correspondence submitted by the Taxpayers to the Revenue. The representative also told the Board that Mr Y had given traffic noise as his reason for selling Apartment F.

5. Reasons for the Decision

5.1 Onus of proof:

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Section 68(4) of the Inland Revenue places the onus of proof in an appeal on the taxpayer. Accordingly, it was for the Taxpayers to satisfy the Board, on balance of probabilities, that the assessment to tax which is under appeal was excessive or incorrect.

5.2 Judicial guidance:

The Revenue drew the attention of the Board to the statement of Lord Wilberforce in Simmons v IRC 53 TC 461, at 491, that:

‘ ... 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. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? ... Intentions may be changed. What was first an investment may be put into the trading stock – and, I suppose, vice versa. ... What is not possible is for an asset to both trading stock and permanent investment at the same time ... it must be one or other ... ’

5.3 Board Decision:

Case D8/90, IRBRD, vol 5, 113, was also produced to the Board. In this case the Board found that the taxpayer had not satisfied it that the purchase of a flat with his brother-in-law was not a venture in the nature of trade. In its decision, at page 116 of the report, the Board had stated:

‘ A trading transaction does not become a capital gain because one decides to reinvest the proceeds in residential property for oneself.’

The Board notes that the report continues:

‘ If it was the intention of the Taxpayer when he acquired flat C to use it as his residence in place of flat A and subsequently for good and valid reasons decided to change his mind and sell flat C and either continue to live in flat A or move to a different flat, in this case flat D, then the gain would be a capital gain and not taxable.’

5.4 The matter in issue:

5.4.1 This appeal did not relate to all of the apartments listed in paragraph 2.1 above. The Board is solely concerned with the \$94,000, net of expenses, received by the Taxpayers in their capacity as confirmors to the assignment of Apartment B.

5.4.2 The information as to these other transactions was put before the Board by the Revenue, in a paraphrase of the words used by its representative, to establish

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that Mr Y's modus operandi as an estate agent was to earn commission income by providing estate agency services and whenever the opportunity presented itself to take part in property dealing activities.

5.4.3 The Board notes that amongst the documents produced by the Revenue were the profits tax returns referred to in paragraph 2.2.3.3 above in which Mr Y volunteered his firm's profits from property dealing.

5.5 The question to be answered:

5.5.1 In the words of the representative of the Revenue, 'The question for the Board to consider is whether the profit the Taxpayers derived from the disposal of a property as confirmors are profits chargeable to tax under section 14 of the Inland Revenue Ordinance.'

5.5.2 The answer to this question must be found from the evidence before the Board, which, in this case, was the evidence of the Taxpayers and the various documents put before the Board.

5.6 Home ownership:

When considering the evidence the Board is entitled to recognise that, at the risk of stating the obvious:

5.6.1 Every person who can afford so to do is entitled to purchase a residence for his and, if any, his family's use.

5.6.2 The Board can see no reason why, under the Ordinance, a person should not own two or more residences, for example one convenient to his place of work, another, perhaps, in the New Territories convenient to a regularly frequented club and, perhaps, another on an outlying island for weekend and recreational use.

5.6.3 There can be no objection to two people cooperating in the purchase of a residence for their joint use. In fairness to the Revenue, it was not suggested that the Taxpayers should not have jointly purchased any of the apartments they purchased together.

5.6.4 Home owners, and whether a family or individuals who find it convenient to share a residence, have the right to change their residences and whether to acquire larger or smaller accommodation, as their needs or means change, or to relocate to what they consider to be a more desirable or more appropriate location.

5.6.5 Whilst it is probable that an individual who is a real estate agent is always at an advantage over other people by virtue of learning of bargains or quality

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properties and those in desirable locations before they are advertised, if he takes advantage of the information which comes to him to improve the quality of his residence or to change to a more suitable residence and/or what he considers a better location the Board can see no reason why he should be treated any differently to any other person. His occupation is irrelevant.

In any of the foregoing situations the excess of the net proceeds of sale over the original cost of purchase is not liable to tax. Such transactions are not ventures in the nature of trade.

5.7 Apartment C:

Mr Y's evidence was that:

5.7.1 This was the first apartment purchased. This evidence was not challenged and is accepted by the Board.

5.7.2 This apartment was purchased at the suggestion of Madam X and with financial support from her mother. No doubt that support was critical as, at the time, he was twenty-six and an employed person on a modest income, as opposed to the proprietor of a business. This evidence was not challenged and is accepted by the Board.

5.7.3 The Taxpayers took up residence some time during July 1985. The Board is satisfied that the documents referred to in paragraph 3.3 above support this.

5.7.4 Within days of moving in, Madam X found the flat too small and the insects intolerable. The flat was in an old building and it has to be recognised that the suitability of a residence is not always fully appreciated until it is occupied. Madam X's views compelled Mr Y to look for another residence and, in a very short time, Apartment B was identified and thereafter secured. The Board accepts all this evidence.

5.8 Apartment B:

5.8.1 It is also beyond doubt that within three and four weeks of the Taxpayers taking up occupation the Taxpayers negotiated a deal which would lead to them becoming the purchasers of Apartment B from M Ltd.

5.8.2 The Revenue emphasised the very short period of time between the acquisition of Apartment C and the Taxpayers' agreement to become the purchasers of Apartment B.

5.8.3 This short period, the Revenue submit, when coupled to Mr Y's involvement in the real estate agency business is indicative of the fact that Apartment B was purchased with a view to a resale at a profit. The submission was that this

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transaction was an extension of his business activities as a real estate agent earning commissions for locating sellers or buyers for property and buying for resale if he thought he could do so at a profit. In his evidence Mr Y had anticipated this submission and suggested his occupation was being held against him. He said that even real estate agents are entitled to own their own homes and sell and buy another as circumstances change without being taxed as a trader in real estate. The Board agrees with him on this.

- 5.8.4 The Revenue also relied on the fact that the Taxpayers found a purchaser for Apartment B just before they would have had to pay the final instalment of \$268,000 to M Ltd as supporting the Revenue's submission that the Taxpayers did not purchase this apartment with a view to living in it but that, all along, they were intending to sell and make a profit. The Board does not accept this submission. The Board accepts the evidence that Apartment B was purchased by reference to the brochure and that the disadvantages could only be identified when an inspection became physically possible.
- 5.8.5 The Revenue also relied on the Taxpayer's later purchases and sales of properties as evidence to support the proposition that the purchase of Apartment B was a venture in the nature of trade. The Board does not consider that these later transactions assist in the determination of this appeal. Whether or not these subsequent transactions were ventures in the nature of trade may or may not be the subject of further disputes between the Revenue and the Taxpayers. As the purchase of Apartment E at Place T took place more than three months after the sale of Apartment B and the purchase of Apartment F took place more than nine months later these transactions do not assist the Board in determining whether the original purchase was or was not as an intended home, an investment, or whether there was or was not a subsequent decision to alter their investment intention to a trading intention. The Board notes that Apartment E is still owned by the lady and Apartment F was used by the Taxpayers as their residence for the four or so months it was owned by the gentleman.
- 5.8.6 The Board does not accept the fact that the Taxpayers sold Apartment B without taking either an assignment or possession establishes that it was either purchased as trading stock or, if that was not the case, that at a date after the contract to purchase was signed and exchanged they changed their original intention. The Board accepts the evidence of the Taxpayers that, having moved into Apartment C, the lady found that apartment did not suit her whereby the gentleman agreed to look for something which she considered more suitable. At the time he was twenty-six and in love and, no doubt, anxious to please the lady who had agreed to marry him and live with him in the meantime. The Board accepts that on 2 August 1985 they were both satisfied that the two bedroom Apartment B with the facilities offered was what they wanted for their living accommodation.

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5.9 Personal Relations:

5.9.1 The Board notes that the Taxpayers have not lived together throughout the period from their taking up occupation of the Apartment C in July 1985 to the date of the appeal. On the occasions they have not had a residence available to them they have returned to live with their respective families.

5.9.2 The sale of Apartment C, possession of which Mr Y says was given to the purchaser in November 1985 required them to do this until the gentleman purchased Apartment F in July 1987, a gap of some twenty-one months, and the sale of that apartment in early December 1987 meant that they were not together from early December 1987 until the lady purchased the apartment in Block E at Place T in or about April 1989, a gap of some fifteen months. They have also lived with their respective families since April or May 1991.

5.9.3 However, the Revenue sought no explanation for these separations and the Board did not consider it should pursue this. There is a good explanation why they did not share Apartment D. Later, they may have had the occasional disagreement and decided to separate. On each occasion that happened, if that is what happened, it is obvious that for one of them to continue to maintain the 'matrimonial home' on his or her income, as disclosed by their salaries tax returns before the Board, would have been an expense neither could have afforded alone. However, the Board does not consider that these unexplained separations have any relevance to the question it has to answer.

5.10 Madam X's business:

The Revenue also elicited evidence from Madam X that, at least since 1988, she has been a director and shareholder of a private company dealing in real estate. The Board does not consider this evidence of assistance in determining this appeal. The fact that she started trading in property, perhaps as late as three or so years subsequent to the events with which the Board is concerned, does not establish that she was trading in August 1985 or October 1986.

5.11 The matter for determination:

The Board is obliged to endeavour to determine from the evidence of the Taxpayers and the documents put before it what was the intention of the Taxpayers at the time they entered into the agreements with respect to Apartment B and whether that original intention was changed subsequently.

5.11.1 Original intention:

The Board accepts the evidence of the Taxpayers as to their reason for entering into the agreement with the first purchaser of Apartment B and the agreement with M Ltd, namely that Apartment C was not to Madam X's liking and that

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they were looking to move into this apartment when it was completed. Accordingly, the Board is satisfied that their original intention was not to buy this apartment with the intention of effecting a resale at a profit.

- 5.11.2 Did that original intention change?
 - 5.11.2.1 That they did sell this apartment without ever having had ownership assigned to them is not in dispute.
 - 5.11.2.2 However, was that decision taken because they could make a profit or was it taken because they decided that Apartment B was not where they wanted to live?
 - 5.11.2.3 One thing is certain: the decision to take over the contract for the purchase of the apartment was taken in a very brief span of time, not more than about three to four weeks from the day they moved into Apartment C. Although there was no evidence as to the demand for apartments in the development of Apartment B, it is common knowledge that most developments sell well as soon as they are offered and that those who are the first to sign contracts with the developer rarely have difficulty in on-selling. Hong Kong is not a place where it is easy to select a preferred area as well as a building providing the required accommodation whereby, when need arises and those criteria are met, an anxious buyer has to move quickly or risk losing the opportunity.
 - 2.11.2.4 Were the Taxpayers' reasons for selling good and valid?
 - 5.11.2.4.1 Mr Y says neither of them was familiar with Place C. The Board accepts this.
 - 5.11.2.4.2 In the letter dated 19 September 1989 to the Revenue, refer paragraph 4.2 above, the Taxpayers explained that neither had lived in the Area, namely Place C or Place S, and that they had not noticed that aeroplanes pass nearby. The Board accepts this.
 - 5.11.2.4.3 In their correspondence to the Revenue no specific mention is made by the Taxpayers of noise from MTRC train operations and they concentrate on air movements saying that it was only after they were able to get close to the development they became aware of this. In response to a question from the Board as to this, Mr Y gave an answer satisfactory to the Board.
 - 5.11.2.4.4 In evidence at the appeal Mr Y said that at the time they contracted to purchase, August 1985, there was no way he could access the site to inspect or take a general view, that they purchased on the strength of the brochure, supported by the opinion of a real estate developer that the development was a good one, and that it was only after the MTRC station opened that an inspection was possible. It was then that they became aware of the noise of the MTRC train operations.

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- 5.11.2.5 The Board accepts that many people will have been exposed to the noise generated by trains moving at speed and those slowing down or starting off. Further, the noise from marshalling and other movements and activities of the MTRC will have to be considerable.
- 5.11.2.6 The Board accepts the Taxpayers' explanation that the decision to sell Apartment B was dictated by what they found out after they were able to access the MTRC station.
- 5.11.2.7 On the evidence accepted by it, the Board is satisfied that Apartment B was purchased by the Taxpayers for use by them as their residence when occupation was permitted, an investment, and that the subsequent sale was not as a result of a change to that intention. In the view of the Board they had good and valid reasons for their decision not to take up possession and to sell and to look elsewhere.

6. Decision

- 6.1 For the reasons given the Board allows this appeal.
- 6.2 The Board orders the profits tax assessment for the year of assessment 1986/87 under Charge Number 2-3867469-87-A dated 7 June 1989 as adjusted by the Commissioner in his determination be annulled.