

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D40/00

Profits tax – real property – whether the gains arising from the disposition of a property was liable for profits tax.

Panel: Ronny Wong Fook Hum SC (chairman), Ng Ching Wo and David Wu Chung Shing.

Date of hearing: 18 April 2000.

Date of decision: 19 July 2000.

By a preliminary agreement dated 26 November 1996 the taxpayers (Mr and Mrs A) purchased Property 3, the subject of this appeal. This purchase was scheduled to be completed on 31 March 1997 when the balance of the purchase price was due and payable. Company I acted as the agent in this purchase and it informed the Revenue that the taxpayers put Property 3 up for sale via their company on 2 January 1997. By a provisional agreement dated 14 February 1997, the taxpayers sold Property 3 with a gain.

The taxpayers informed the Revenue that Property 3 was purchased for their own use. They wanted to move from Property 2 to Property 3 for traffic convenience of Mrs A but were told by their friends after the purchase of Property 3 that traffic via the tunnel was very heavy during peak hours. They therefore decided to sell Property 3.

Almost immediately after their sale of Property 3, the taxpayers entered into an agreement dated 17 February 1997 for the purchase of Property 4. The taxpayers said that Property 4 was selected as Mr A wanted to have a house with a garden. Company I again acted as the agent in this purchase and they informed the Revenue that they were instructed by the taxpayers to sell Property 4 on 12 March 1997. By property tax returns dated 9 October 1999 the taxpayers informed the Revenue that Property 4 was left vacant for the period between 1 April 1997 and 31 March 1999.

Held, dismissing the appeal:

1. The Board had to be satisfied that the taxpayers' intention at that time was to purchase Property 3 as their residence and such intention was on the evidence 'genuinely held, realistic and realisable'. The decision to purchase Property 3 was a hasty one. The flat was bought on 26 November 1996 and sold on 14 February 1997. These were strong indicia of a rapid sale for profit and there was no settled intention to hold the unit on a long term basis.

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2. The traffic convenience of Mrs A was given as the principal reason for the move from Property 2. The taxpayers did very little to find out the traffic condition of Property 3 prior to their purchase. Even more important was their selection of Property 4 as they were prepared to bow to Mr A's wish to have a garden instead of accommodating Mrs A's traffic convenience. The traffic consideration was therefore not a weighty nor a pressing factor at that point of time.
3. The taxpayers laid considerable emphasis on their purchase of Property 4 as their residence after their sale of Property 3. The Board was not convinced that Property 4 was purchased with intention. Property 4 was available for sale. The taxpayers were looking for a substantial profit.

Appeal dismissed.

Case referred to:

All Best Wishes Limited v CIR 3 HKTC 750

Ngan Man Kuen for the Commissioner of Inland Revenue.
Taxpayers in person.

Decision:

Background

1. The Taxpayers [' Mr and Mrs A '] are husband and wife. Mrs A is a real estate agent. She registered a real estate agency on 30 September 1992. Mr A is a sale executive. They have one child born on 9 October 1981.

2. By an agreement for sale and purchase dated 30 January 1992, Mr and Mrs A purchased a unit at District B [' Property 1 '] for \$3,284,837. Property 1 was initially mortgaged in favour of Bank C on 23 February 1993. This was replaced by a mortgage in favour of Bank D dated 14 June 1996. Property 1 was eventually sold by Mr and Mrs A on 29 January 1999 for \$4,300,000. In property tax returns dated 13 July 1997, Mr A declared that Property 1 was used wholly by the owners for residential purposes for the period between 1 April 1993 and 14 February 1995 and was let out for a short period between 16 and 31 March 1995. In a further property tax return dated 18 November 1998, Mr and Mrs A declared that Property 1 was wholly let for the period between 1 April 1996 to 31 March 1998.

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3. By an agreement for sale and purchase dated 19 March 1994, Mr and Mrs A purchased as joint tenants a unit at District E in the New Territories [' Property 2 '] for \$6,750,000. Property 2 was initially mortgaged by them in favour of Bank F. That mortgage was replaced on 27 August 1996 by another mortgage in favour of Bank G for \$3,850,000. Property 2 was eventually sold on 8 January 1998 for \$7,380,000.

4. By a preliminary agreement dated 26 November 1996, Mr and Mrs A purchased a unit at District H in the Hong Kong Island [' Property 3 '] for \$6,380,000. This purchase was scheduled to be completed on 31 March 1997 when the balance of the purchase price of \$5,742,000 was due and payable. Company I acted as the agent in this purchase. In a letter dated 29 November 1999, Company I informed the Revenue that Mr and Mrs A put Property 3 up for sale via their company on 2 January 1997. By a provisional agreement dated 14 February 1997, Mr & Mrs A sold Property 3 for \$7,238,000. The issue before us is whether they are liable for profits tax in respect of the gains they made in dealing with Property 3.

5. Almost immediately after their sale of Property 3, Mr & Mrs A entered into an agreement dated 17 February 1997 for the purchase of a house at District J [' Property 4 '] at \$7,150,000. Property 2 was given as their address in this agreement for sale and purchase. The purchase was scheduled to be completed on 3 July 1997. Company I again acted as the agent in this purchase. In a letter dated 3 April 2000, Company I informed the Revenue that they were instructed by Mr and Mrs A to sell Property 4 for \$9,000,000 on 12 March 1997. Computer records of Company I contained references such as ' Mrs A reply to me \$9,000,000 is hard price at this moment ' of 4 April 1997; ' Mrs A said still good price for sell ' of 23 April 1997 and ' Mrs A said change price to \$9,500,000 can 3-4 month comp ' of 24 June 1997. An offer of \$8,000,000 was rejected on 24 April 1997. Property 4 was subsequently offered for lease on 2 July 1997. According to the computer records of Company I, Property 4 remained in the market either for sale or for let. The latest record of Company I relates to an offer for sale on 15 March 2000 at \$4,800,000. At all material times, Mr and Mrs A mortgaged Property 4 in favour of Bank K. By property tax returns dated 9 October 1999, Mr A informed the Revenue that Property 4 was left vacant for the period between 1 April 1997 and 31 March 1999.

Pre-hearing correspondence between Mr and Mrs A and the Revenue

6. By letter dated 18 October 1998, Mr A informed the Revenue that Property 3 was purchased for their own use. However after considering the location and size of the property and the fact that car parks in the complex had to be rented for use, they decided to sell that property. They now hold a further piece of property at District L for rental purposes.

7. Mr and Mrs A further explained to the Revenue by their letter dated 6 September 1999 that :

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- (a) Their residential addresses during the relevant period were :
 - (i) Property 2 for the period between April 1996 and March 1998;
 - (ii) Property 4 for the period between March 1998 to date and
 - (iii) a flat at District M [' Property 5 '] for the period between February 1999 to date.
- (b) They were residing at Property 2 when they purchased Property 3. Mrs A was then working on the Hong Kong Island side. They wanted to move back to Hong Kong Island for the convenience of Mrs A. Property 3 was selected by chance. They were told by their friends after the purchase that traffic via the tunnel (between District H and Mrs A' s workplace) was very heavy during peak hours. Furthermore they would have to spend \$4,000 to rent a car park. They therefore decided to sell Property 3.
- (c) Property 2 is 1,068 square feet in area with 3 bedrooms and 2 sitting rooms. Property 3 has similar partitions but its area is only 931 square feet. Property 4 has the largest area at 1,463 square feet.
- (d) Property 5 was rented for the working convenience of Mrs A.

The hearing before us

8. Mr and Mrs A both gave sworn evidence. Mrs A was very eloquent. She did her best to address the issues in this appeal in a calm and reasoned manner. It is clear that she is under severe stress as a result of the drop in value of her portfolio of properties. By contrast, Mr A was rude and prone to disruptive outbursts. He made little contribution in advancing the case which his wife was trying ever so hard to present.

9. Mrs A' s evidence may be summarised as follows :

- (a) At all material times, his son was studying in China. He went abroad six months ago to continue his education.
- (b) She became a member of a branch office of Company I in about the end of 1995. She had no computer access to units offered for sale in other branches of Company I.
- (c) She was residing in Property 2 in November 1996. Mr A had to drive her to work on the Hong Kong Island side. Each trip took about an hour.

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- (d) She accompanied her friend to District H. The development was attractive. She inspected Property 3 once with Mr A. She was urged to make a speedy decision as other buyers were in the market. The provisional agreement for sale and purchase was signed by her superior in Company I on her behalf as the matter was pressing and she was at home. Although Property 3 was smaller than Property 2, easy access was her prime consideration.
- (e) After the purchase she was told by her relatives that the *fung shui* in Property 3 was poor. She also found out about the congestion in the tunnel. She regretted the purchase and decided to sell.
- (f) Property 4 was selected as Mr A wanted to have a house with a garden. She moved into Property 4 immediately after completion of the purchase. Her husband was in error in informing the Revenue in the property tax returns that Property 4 was vacant from 1 April 1997 to 31 March 1999. Her husband was very fond of the house. He purchased a 48" TV for use in the house. She invited friends to Property 4 after they moved in in 1997.
- (g) She challenged the accuracy of the computer entries maintained by Company I in relation to Property 4. She purchased that house via Company I. The agent there was trying to generate business by testing her interest. She refused to give the keys of Property 4 to the agent as she did not have a genuine interest to sell.

10. Rid of his outbursts, the following points emerged from Mr A's testimony :

- (a) When he submitted the property tax return in respect of Property 4 to the Revenue, Property 4 was not let to any tenant. He therefore took the view that Property 4 was vacant.
- (b) He only had a couple of property deals within the seven years between 1993 and 2000. He was forced to sell as a result of the financial crisis in 1997.

11. With the consent of the Revenue, Mr and Mrs A tendered for our consideration a bundle of photographs in respect of Property 4. The huge TV and the air-conditioner purchased from their predecessor in title are clearly shown in those photographs.

The applicable principles

12. The principles are clear. We have to ascertain the intention of Mr and Mrs A at the time when Property 3 was purchased. We have to be satisfied that their intention was to purchase the same as their residence and such intention is on the evidence 'genuinely held, realistic and

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realisable’ .

13. As pointed out by Mortimer 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

14. Both Mr and Mrs A complained bitterly that the Revenue seems to harbour a discriminatory attitude towards real estate agents. We detect no such hostile attitude on the part of the Revenue. The occupation of a taxpayer is at times an important consideration in the ascertainment of his intention. However, in the circumstances of this case, we are of the view that the profession of Mrs A (which we respect) has little relevance.

15. On their own admissions, the decision to purchase Property 3 was a hasty one. The flat was bought on 26 November 1996 and sold on 14 February 1997. These are strong indicia of a rapid sale for profit and there was no settled intention to hold the unit on a long term basis.

16. The traffic convenience of Mrs A was given as the principal reason for the move from Property 2. The couple did very little to find out the traffic condition of Property 3 prior to their purchase. Even more important is their selection of Property 4. On their own case, they were prepared to bow to Mr A’s wish to have a garden instead of accommodating Mrs A’s traffic convenience. The traffic consideration was therefore not a weighty nor a pressing factor at that point of time.

17. Mr and Mrs A laid considerable emphasis on their purchase of Property 4 as their residence immediately after their sale of Property 3. We are not convinced that Property 4 was purchased with that intention. First, Mr A gave no convincing explanation as to why he filled in property tax returns in respect of Property 4 in the way he did . If those returns be right, Property 4 was left vacant between 1 April 1997 and 31 March 1999. Secondly, if reliance is placed on Mr A’s letter of 6 September 1999, they moved out of Property 2 and into Property 4 in March 1998. Had they not moved out of Property 2, they would not have sufficient funds to support their mortgage repayments. Thirdly, we find it difficult to dismiss the vivid description in the numerous computer entries maintained by Company I as wholly inaccurate in reflecting the then attitude of Mrs A. Property 4 was available for sale. Mr and Mrs A were looking for a substantial profit. Unfortunately the market turned against them.

18. For these reasons, we are of the view that Mr and Mrs A were correctly assessed. We

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dismiss their appeal.