

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D44/95

Profits tax – purchase on sales of property – whether profit assessable to profits tax.

Panel: Robert Wei Wen Nam QC (chairman), Chow Cheuk Yu Alfred and Lo Lai Yee Dora.

Dates of hearing: 1 and 5 June 1995.

Date of decision: 4 August 1995.

The taxpayers purchased and sold a property. The profit was assessed to property tax. The taxpayers argued and gave evidence that the profit should not be assessed to property tax.

Held:

The Board was not satisfied that it was a capital gain. The Board held that the property was a trading asset and the profit derived from its resale was assessable to profits tax.

Appeal partly allowed.

Cases referred to:

Simmons v IRC STC 350
All Best Wishes Ltd v CIR 3 HKTC 750

Wong Ki Fong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal by two taxpayers who are husband (T1) and wife (T2) against the profits tax assessment raised on them for the year of assessment 1990/91. The subject of the assessment is the estimated profit derived by the Taxpayers from the purchase and resale of a flat in District Y (the subject property).
2. The statement of the grounds of appeal filed with the Board of Review sets out the following grounds:

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- '(1) The monthly income is not enough for the loan repayment as the interests have increased.
- (2) T1 is a taxi-driver with no fixed income.
- (3) Originally we intended to purchase the property for our marriage and live with the family of T1.
- (4) Later, the elder brother of T1 purchased a larger unit in District T. He asked us to live together so as to reduce the burden for loan repayment.'

3. At the hearing, both the Taxpayers appeared. T2 represented herself and T1. T2 gave evidence for the Taxpayers. No other witness was called.

4. From the testimony of T2 and the documents put before the Board, the following primary facts emerge.

4.1 By an agreement for sale and purchase dated 28 February 1990, the Taxpayers purchased the subject property which was under construction for \$882,100.

4.2 The downpayment of \$88,210 was borrowed from T2's mother while the rest of the purchase consideration was financed by an equitable mortgage loan of \$793,890 from a finance company. The mortgage loan was repayable by 240 monthly instalments of \$8,319.40 each (except the first instalment which was \$7,792.90).

4.3 By an agreement for sale and purchase dated 28 June 1990, T1's father and brother jointly acquired a flat in District T for \$1,266,300.

4.4 The purchase was financed by a bank mortgage of \$957,900.13 and an interest-free loan of \$130,000 under a home purchase loan scheme. Both the bank mortgage loan and the government loan were repayable by 180 monthly instalments totalling about \$11,000 per month.

4.5 By an agreement for sub-sale and purchase dated 28 December 1990, the Taxpayers sold the subject property for \$1,128,000. The Taxpayers subsequently acted as confirmors in the assignment of the subject property to the purchaser.

4.6 The occupation permit for the subject property was issued on 9 April 1991.

4.7 Taking into account stamp duty, mortgage interest and legal fee on sale, the Taxpayers made a profit of \$149,700 from the sale of the subject property.

4.8 During the years of assessment 1989/90 and 1990/91, T2 was a sales assistant in a firm owned by her father and his brothers and sisters while T1 was a relief taxi-driver. Their earnings during the two years were as follows:

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		\$	
1989/90	T1	36,000	
	T2	<u>56,800</u>	
		92,800	(averaging \$7,733 per month)
		\$	
1990/91	T1	38,000	
	T2	<u>66,800</u>	
		104,800	(averaging \$8,733 per month)

4.9 At all relevant times, the Taxpayers owned a flat in Kowloon (the Kowloon property). The purchase was partly financed by a bank loan secured by the mortgage of a property which belonged to T1's mother. The Kowloon property was let at a monthly rent of about \$2,720, while bank loan instalments were about \$3,000 per month. Thus there was a shortfall of about \$300 per month.

5. The taxability or otherwise of a profit derived by a person from the sale of an asset turns on his intention at the time of its acquisition. If the intention was to dispose of it at a profit, the asset was a trading asset, and the profit is a trading profit and is taxable. If the intention was to hold it as a long-term investment, the profit is a capital gain and is not taxable. At any given time, an asset is either a trading asset or a long-term investment; it cannot be both; it cannot be neither (see Simmons v IRC STC 350 at page 352). In this appeal, the onus is on the Taxpayers to prove that, at the time of its acquisition, their intention was to hold the subject property as a long-term investment, that is, as their home where they would reside after their marriage. On the question of intention, Mortimer J said in All Best Wishes Ltd v CIR 3 HKTC 750 at page 771:

'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. Indeed, decisions upon a person's intention are commonplace in the law. It is probably the most litigated issue of all. 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...'

6. T2's testimony may be summarised as follows.

6.1 In 1989 the Taxpayers were planning to get married. They purchased the Kowloon property (see paragraph 4.9 above) as their home after marriage. The Kowloon property had been let for 30 years. The Taxpayers orally requested the tenant to move out

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but the tenant refused. The Taxpayers did not realise that there would be difficulties in recovering possession until they had purchased the subject property.

6.2 As a result, they purchased the subject property in District Y in February 1990. The idea was that it would be used as their home after their marriage and that T1's parents, brother and sister would also come and live with them there. There was an understanding with T1's parents and brother that they would start making contributions towards the repayment of the mortgage loan after moving in. T1's brother promised that after moving in, he would pay his mother a sum each month out of which she would have the sole discretion to pay something towards the loan repayment. Beyond that there was no agreement as to how much the contributions would be. Until T1's parents and brother had moved in, the Taxpayers had to meet their obligations unaided.

6.3 The Taxpayers' earnings were barely sufficient to cover the loan instalments (see paragraphs 4.2 and 4.8 above), let alone the shortfall in relation to the Kowloon property (see paragraph 4.9 above) and living expenses. T2 had to borrow from her mother to make ends meet.

6.4 In June 1990, T1's father and brother purchased the District T property (see paragraph 4.3 above). T1's parents preferred to live in District T because there were fewer factories there than in District Y. They asked the Taxpayers to sell the subject property, come and live at the District T property and contribute towards the repayment of loans raised for the purchase of the District T property.

6.5 In December 1990, the Taxpayers sold the subject property (see paragraph 4.5 above). They did not sell earlier because of unfavourable market conditions.

6.6 In June 1991, the occupation permit for the District T property was issued. T1 moved in, and paid \$3,000 per month to his mother. On 9 November 1991, the day of her marriage, T2 moved in. Thereafter she also paid \$3,000 per month to T1's mother, who had the sole discretion over how much of the monthly payments should go towards the repayment of the loans.

6.7 The Taxpayers lived at the District T property until June 1992 when they moved to a rented flat in District O. In 1994, they were able to sell the Kowloon property and used the proceeds of sale to purchase a property in District K. In February 1994, they moved to the District K property and have lived there since.

7. We accept T2's testimony as summarised above.

8. In her final submission, Miss Wong the representative of the Commissioner of Inland Revenue commented on the Taxpayer's lack of means to hold the subject property as a long term investment. In her reply, T2 stated that at the time of acquisition, the Taxpayers thought that they would be able to do so because T1 was then a full-time taxi-driver, and only became a relief taxi-driver later. It had never before been asserted that T1 was at first a

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full-time taxi-driver. In our view, that was an afterthought inspired by Miss Wong's submission. We have therefore disregarded the statement in our evaluation of the evidence.

9. On the evidence, can it be said that at the time of acquisition, the Taxpayers had an intention of holding the subject property for long-term purposes, an intention which was 'genuinely held, realistic and realisable'? Our answer is no. The Taxpayers desired to make the subject property their home, but it was uncertain that they would be financially able to do so. T1's parents might or might not move in and make contributions; they gave no commitment to do so. All that there was a vague understanding. It seems to us, and we find, that at the time of acquisition, the Taxpayers embarked on an adventure in the nature of trade and intended to turn the subject property to account by resale at a profit at an opportune time, while entertaining a contingent hope that T1's parents and brother would move in and make meaningful contributions to enable the Taxpayers to retain the subject property as their home. Had the contingency materialised, the subject property would thereby have been turned into a long-term investment, but it did not. The subject property was a trading asset throughout the period of the Taxpayer's ownership. The profit derived from its resale is assessable to profits tax.

10. Miss Wong informed the Board that the assessable profits were \$149,700 with tax payable thereon of \$22,455, but that the tax charged was \$34,500. There was therefore an excess amount of \$12,045.

11. We hereby direct that the assessment in question be reduced accordingly. Subject to that, this appeal is dismissed.