

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D49/89

Profits tax – adventure in the nature of trade – government servant purchasing premises he occupied as tenant in anticipation of home purchase scheme being implement – subsequent sale of premises at a profit – whether adventure in the nature of trade.

Panel: T J Gregory (chairman), Norman Leung Nai Pang and Benny Wong Man Ying.

Date of hearing: 7 November 1988.

Date of decision: 11 September 1989.

The taxpayer was a government servant who agreed to purchase the premises which he was occupying as a tenant. He did so in the anticipation that his employer would provide the necessary finance through a home purchase scheme. Subsequently he found out that he could not benefit from the home purchase scheme and decided to sell the premises which he had agreed to buy and realised a substantial profit. The profit was taxed as an adventure in the nature of trade. The taxpayer appealed against this assessment on the ground that he had sold the flat because of a change of intention.

Held:

The appeal was allowed and the assessment annulled. The Board rejected the contention by the Revenue that it was the intention of the taxpayer when he contracted to purchase the premises that he should resell them at a profit. The Board was satisfied that there had been a genuine change of intention on the part of the taxpayer because of a change in the circumstances.

Appeal allowed.

Cases referred to:

D64/87, IRBRD, vol 3, 60
D14/87, IRBRD, vol 2, 369
Turner v Last 42 TC 517

Ho Chi Ming for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

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1. THE NATURE OF THE APPEAL

The Taxpayer appealed against an assessment to profits tax raised on him by the Revenue in respect of a transaction which the Revenue determined was an adventure in the nature of trade.

2. THE FACTS

2.1 In or about September 1975 the Taxpayer took a tenancy of the flat and car park ('the premises') identified in paragraph 1(1) of the determination of the Commissioner dated 4 November 1987.

2.2 The Taxpayer was at the material times and continues a government servant and whilst the occupant of the flat was drawing a private tenancy allowance.

2.3 By letter dated 31 May 1979 the managing agents of the block of flats in which the premises were located gave the Taxpayer notice that his tenancy would not be renewed after its expiry on 31 August 1979. By letter dated 25 June 1979, in reply to a letter dated 10 June 1979 addressed by the Taxpayer to the managing agents, the Taxpayer was offered an extension of his tenancy from 1 September 1979 to 30 April 1980. This offer was accepted.

2.4 The Taxpayer subsequently received a further letter from the managing agents, dated 17 August 1979, advising him that the premises, excluding the car park, were available for sale to him at a price of \$1,044,750. A 'tear-off' slip invited him to confirm his interest on or before noon on 31 August 1979.

2.5 On 15 August 1979 the government issued a circular with respect to the provision by government of assistance to civil servants towards the purchase of residential accommodation. The existence of this circular became known to the Taxpayer at or about the time he received the letter referred to in the preceding paragraph and was reviewed by the Taxpayer with officers of the Senior Non-Expatriate Officers Association and also with other civil servants who were occupants of flats in the same block as the premises. A committee, to represent their interests, was established.

2.6 The Taxpayer completed the slip attached to the letter dated 17 August 1979 and returned this to the managing agents on 30 August 1979. This form requested that the formal offer to sell be forwarded to him at the earliest opportunity.

2.7 On 21 September 1979 a formal 'Confirmation of instruction' was received by the Taxpayer which he signed. Having signed the formal confirmation of sale

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on 21 September the Taxpayer knew that he would have to pay \$146,712.50 with respect to the flat when the sale and purchase agreement was ready, said to be within fourteen days, and a further instalment of \$156,712.50 would be payable in late December.

- 2.8 On 31 October 1979 a formal 'Confirmation of instruction' for the sale of the car park at a price of \$20,000 was received and signed by the Taxpayer which required him to pay \$3,000 on the signing of the sale and purchase agreement and a further \$3,000 at the same time as the second instalment for the purchase of the flat, refer paragraph 2.7 above. The entirety of the balance of the purchase price of the flat, \$731,325, and for the car park, \$14,000, were payable on completion of the sale and purchase which was scheduled to be within the first two weeks of July 1980.
- 2.9 As a result of various meetings the Taxpayer became aware of the possibility of home purchase scheme could be delayed and, probably, would not come in time for him to complete the acquisition of the property. Additionally, under government regulations even if he got a mortgage he would not be able to occupy the premises.
- 2.10 Having committed to purchase the premises the Taxpayer received, by various methods, approaches from would-be purchasers and, eventually, decided that it would be appropriate to accept one of these offers which was for \$750,000 more than his commitment.
- 2.11 The agreement for the sale and purchase of the premises by the Taxpayer at a price of \$1,064,750 was signed and exchanged on 19 November 1979 and on 20 November 1979 the Taxpayer entered into a sale and purchase agreement for the sale of the premises to a corporate purchaser, A Limited, at a price of \$1,139,750.
- 2.12 Having completed the transaction he then was assessed to tax on the difference between his cost price and the price at which he sold his property.

3. DOCUMENTATION

- 3.1 The Board had before it the following documents:
- 3.1.1 The Taxpayer's grounds of appeal dated 3 December 1987;
- 3.1.2 The determination of the Commissioner dated 4 November 1987;
- 3.1.3 A copy of an agreement between B Limited and C Limited dated 21 June 1979 for the sale of the property in which the premises are located, appendix A to the determination;

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- 3.1.4 The offer dated 17 August 1979 accepted by the Taxpayer on 30 August 1979, appendix B to the determination;
- 3.1.5 A copy of a letter from the Revenue to the Taxpayer dated 30 April 1986, appendix C to the determination;
- 3.2 At the hearing the Taxpayer produced copies of the following documents:
 - 3.2.1 The letter dated 31 May 1979 from the managing agents notifying him that his tenancy would not be renewed, which was admitted as an exhibit and marked exhibit A-1;
 - 3.2.2 The letter dated 25 June 1979 from the managing agents offering an extension to the period of tenancy, which was admitted as an exhibit and marked exhibit A-2;
 - 3.2.3 The offer dated 17 August 1979 from the managing agents to sell the property, which was admitted as an exhibit and marked exhibit A-3;
 - 3.2.4 The government circular no 25/79, dated 15 August 1979, which was admitted as an exhibit and marked exhibit A-4;
 - 3.2.5 A letter dated 14 August 1979 from the Hon Secretary of the Senior Non-Expatriate Officers Association to a civil servant, which was admitted as an exhibit and marked exhibit A-5;
 - 3.2.6 The confirmation of instruction for the sale of the flat from the owner to the Taxpayer, dated 21 September 1979, which was admitted as an exhibit and marked exhibit A-6;
 - 3.2.7 The confirmation of instruction for the sale of the car park from the owner to the Taxpayer, dated 21 September 1979, which was admitted as an exhibit and marked exhibit A-7;
 - 3.2.8 Notice of a meeting of tenants in the apartment block who were in government service, dated 26 September 1979, which was admitted as an exhibit and marked exhibit A-8;
 - 3.2.9 Debit note of Messrs Iu & Lai, dated 22 November 1979, which was marked as an exhibit and marked exhibit A-9;
 - 3.2.10 Debit note of Messrs Ng and Yung, dated 19 November 1979, which was marked as an exhibit and marked exhibit A-10;

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3.2.11 Board of Review Decision D64/87.

3.3 During the course of its submission the Revenue submitted a copy of the decision of the Board of Review, D14/87, IRBRD, vol 2, 369.

4. CASE FOR THE TAXPAYER

The Taxpayer gave evidence to the following effect:

4.1 The facts set out in paragraph 2 above.

4.2 When in mid-August 1979, he received a copy of the circular, exhibit A-4, with respect to assistance to government servants in the acquisition of their residential properties, he proceeded to endeavour to get information. Was the scheme definite? When would it be implemented?

4.3 There were many civil servants living in the same block and all were occupying flats as private tenants. All received a copy of the circular and therefore they decided to organize to protect themselves. The group approached a Mr X, another government servant resident in the apartment block, to act as their representative. They formed an 'association' and all government servants who were living in the block became members. They nominated Mr X to represent them and attend meetings on this proposal. At or about the time the circular was received the Secretary of the Senior Non-Expatriate Officers Association wrote to Mr X inviting him to attend a meeting to discuss this proposal and the Taxpayer said that he subsequently learned that Mr X attended this meeting. Later he was given to understand that the scheme was definite. The residents of the apartment block questioned Mr X on the outcome of the meeting, which was held on 24 August 1979, and the Taxpayer's recollection was that they were told that a scheme would be implemented in the near future. One of the reasons given was the saving of government expenditure in the long term on rental allowances incurred for private tenancies for non-accommodated officers.

4.4 The Taxpayer stated that he reviewed his financial position and looked into payment terms for buying the premises. After he was satisfied he could pay the deposit the initial payment, and on the basis a home purchase scheme would be implemented which would enable him to pay the balance of the purchase price, he decided to accept the landlord's offer and continue to live in the premises. The premises were convenient to his office, his children's school and his servant's flat.

4.5 On 30 August 1979 he signed and returned the form, refer paragraphs 2.4 and 2.6 above.

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4.6 The Taxpayer said that shortly thereafter he was approached by several people who were interested in buying his flat. They called personally, they telephoned or they left messages in his letter box or pushed envelopes under his door. Whilst this was going on he learned that the scheme could be delayed; he could not identify a source but assumed that he had been told by Mr X. He was told that a points scheme was to be developed and that those with longer service would receive greater priority.

The Taxpayer stated he realized that the scheme might not be in time to assist him in completing the purchase of the property. Even if he got a private mortgage he would not be allowed to live in the flat, as that was against government regulations, a matter agreed to by the representative of the Revenue. The buyers were persistent but details were not kept by him. One offer was very reasonable which he decided he had to accept. On 19 November 1979 he signed the sale and purchase agreement for the premises and on the following day contracted to sell the flat to the offeror at a profit. In due course, the transaction was completed and there was a price difference of \$75,000 which the Taxpayer received. He vacated the flat towards the end of November and found another tenancy for which government pays the rent.

4.7 The Taxpayer insisted that he had not acted with a view to making a profit: he wanted to stay where he had been living for some years, which was convenient for his work, his children's school and family, and the ability to take advantage of a government financed scheme induced him to agree to acquire the flat.

4.8 At the material time the Taxpayer owned with his sister a flat in Kowloon which was registered in his name as he was able to obtain a mortgage. As he knew he had to pay some \$300,000 towards the end of 1977 he agreed with his sister to sell his share for \$300,000. The market price was \$500,000 but he agreed to sell his share to her. The witness produced an account for professional services with relation to this transaction, exhibit A-10.

4.9 The Taxpayer concluded his evidence by referring the Board to D64/87, IRBRD, vol 3, 60.

The Taxpayer, although vigorously examined by the Revenue's representative, was firm in his evidence as to the events which took place and his motives. The Board sees little point in reviewing the cross-examination in detail.

5. SUBMISSIONS

A written submission was made by the Revenue during which the proposed housing benefit scheme was reviewed and the Taxpayer's history as an occupant of private premises as a government servant. The Revenue submitted that:

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- 5.1 at the material time there was no reasonable expectation that the home purchase scheme would be implemented in time to assist the Taxpayer in purchasing the premises;
- 5.2 that the Taxpayer had adduced no evidence as to what would cause him to believe that the scheme would be implemented in time;
- 5.3 even if the scheme had been implemented the Taxpayer would not have retained the premises because of the insufficiency of finance and that his position was better if he continued to draw the old benefits;
- 5.4 that the notice to quit from the landlord was not a compelling reason to purchase the premises and that the short period between contracting to purchase and contracting to on-sell, twenty-four hours, was evidence pointing to an adventure in the nature of trade.
- 5.5 The Revenue then proceeded to refer to the case of Turner v Last 42 TC 517 and quoted various passages at length. The Revenue also referred the Board to D14/87, IRBRD, vol 2, 369.

6. REASONS FOR THE DECISION

- 6.1 There are two conflicting Board decisions on identical facts:
 - 6.1.1 D14/87, the case referred to by the Revenue; and
 - 6.1.2 D64/87, the decision referred to by the Taxpayer.
- 6.2 In D14/87 the Board came to the view that the Taxpayer had not discharged the onus upon him whereas in D64/87 the Board held in favour of the taxpayer.
- 6.3 This Board concurs with the Board which delivered decision D64/87 and adopts paragraphs 8 and 9 of that decision with respect to the intent of section 14 of the Ordinance, namely that that section is aimed at profits arising from a trade or business which has been carried on.
- 6.4 In common with the facts in D64/87, the Revenue attempted to persuade the Board that at the time the Taxpayer contracted to purchase the premises the only intent he had in his mind was to resell at a profit. The Board is satisfied from the Taxpayer's evidence that between the receipt of the offer letter of 17 August 1979 and his acceptance of that offer he became aware of the circular of 15 August 1979 from the government with respect to the government assistance to civil servants towards the purchase of personal accommodation. At the time the property market was rising and the offer price was favourable. The Taxpayer had no reason to suspect that the circular was anything but

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genuine: it was logical for government to seek to limit its expenditure on rentals for private tenancies by affording civil servants the opportunity to buy their accommodation whereby the Taxpayer could rightly believe that the proposed scheme would offer him a genuine opportunity to acquire ownership of a flat which he described as convenient to his office, his children's school and his servant's home.

- 6.5 It is all too easy, almost ten years later, to treat the circular with benefit of the knowledge that the proposal did not proceed and impute to the intended beneficiaries knowledge that it would not proceed. However, with respect to the Revenue, this would require the Board to find that, at the material time, the circular was not genuine and, perhaps, was a device to attempt to dissuade civil servants from pressing for a scheme of the nature under consideration. Alternatively, the Revenue would seek to persuade the Board that no reasonable man could have anticipated a scheme of the nature under consideration from being capable of being finalised within the time frame needed to enable the Taxpayer to acquire the premises. For the Board to accept this argument the Board would have to accept that, in effect, the circular was not the result of a detailed study within the government prior to it being issued, something which the Board is not prepared to accept.
- 6.6 The Revenue also seek to persuade the Board that the fact that the Taxpayer signed the sale and purchase agreement on 19 November and contracted to on-sell the following day is indicative of an adventure in the nature of a trading activity. With respect, the Revenue have overlooked the fact that the initial commitment to purchase was made by the Taxpayer on 30 August 1979 when he signed and returned the acceptance form annexed to the letter from the agents dated 17 August 1979 and that this was followed up by the signing of two 'Confirmation of instruction' on 21 September 1979 and 31 October 1979.
- 6.7 The Board accepts that the Taxpayer was telling the truth when he said that his commitment to purchase was based in the hope and expectation that the proposed scheme would have come to fruition and the Board accepts the fact that had the scheme been in place in November 1979, or its implementation assured by July 1980, the date for completion, that the Taxpayer would have completed the purchase.
- 6.8 In apparent contrast to the taxpayer in D14/87, the Taxpayer was specific as to dates and this Board views his evidence as entirely consistent with that of a man with a genuine belief in the prospect of obtaining financial assistance to acquire his residence, a residence which he wished to continue to occupy.
- 6.9 In common with the Board in D64/87, this Board is of the view that there were no activities of a commercial nature which could properly demonstrate that this purchase and on-sell was an adventure in the nature of a trade.

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7. DECISION

For the reasons given this appeal is allowed and the assessment, as confirmed by the Commissioner, is discharged.