

Case No. D53/06

Profits tax – property – investment or trade

Panel: Patrick Fung Pak Tung SC (chairman), Emily Lam Yuet Ming and Brian Lo Kin Hang.

Date of hearing: 12 September 2006.

Date of decision: 26 October 2006.

The taxpayer bought a property still in construction in November 2002 at \$4.43 millions and sold it in February 2004 at \$6.38 millions shortly before its completion.

The Revenue was of the view that the purchase and sale of the property was in the nature of trade and therefore the profit was assessable to profits tax.

The taxpayer contended that she sold the property because she found it very inconvenient for her aged mother to get to the MTR Station from the property because of the hoardings.

Held:

1. The Board believed the reason provided by the taxpayer and found her original intention of buying the property was to use it as residence.

Appeal allowed.

Taxpayer in person.

Tang Hing Kwan and Leung Wing Chi for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal by the Appellant ('the Taxpayer') against the determination by the Respondent ('the Commissioner') whereby she, acting by one of her deputies, overruled the objection by the Taxpayer against a profits tax assessment against her for the year of assessment 2004/05 showing assessable profits of \$1,700,000 with tax payable thereon of \$272,000 subject

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to the decision by the Commissioner to reduce the assessable profits to \$1,660,709 with tax payable thereon of \$265,713.

2. The assessment in question arises out of the acquisition and sale by the Taxpayer of a real property in the following circumstances :

- (a) By an agreement for sale and purchase dated 27 November 2002 ('the SP Agreement') the Taxpayer agreed to purchase from Company A a property at Address B ('the Property') at a consideration of \$4,435,000. The terms of payment were as follows :

	\$
First deposit on signing the agreement preliminary to the SP Agreement	221,750
Further deposit upon signing of the SP Agreement	221,750
Balance payable on or before 27 December 2002	3,991,500
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	<u>4,435,000</u>

- (b) At the time of purchase by the Taxpayer, the Property was still under construction. The Occupation Permit for the Property was issued on 16 October 2003 and the Property was assigned to the Taxpayer on 19 March 2004.
- (c) Meanwhile, on 26 February 2004 the Taxpayer entered into a provisional sale and purchase agreement ('the Provisional Agreement') to sell the Property for a consideration of \$6,380,000. The sale transaction was completed on 13 April 2004.

The Taxpayer

3. The Taxpayer gave evidence on oath. The background facts have not been challenged by the Commissioner.

4. The Taxpayer is a qualified accountant and a Fellow of the Hong Kong Society of Accountants. She was educated at School C and then attained a degree in accountancy from

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University D. She worked in an audit firm for three years before joining Department Ein Government in 1982 where she is still working.

5. The Taxpayer is single. She lives with her mother (aged about 74 years) in a flat known as Address F ('Property G'). She and her family used to live in a flat in District H belonging to her father. In 1997, she qualified for a housing allowance granted by Government. She therefore purchased Property G which was an old property and has been using that as a residence for her mother and herself.

The case of the Commissioner

6. The Commissioner relies on section 14(1) of the Inland Revenue Ordinance Chapter 112 ('IRO') and argues that the Taxpayer's acquisition and sale of the Property was in the nature of trade and therefore the profit she made was assessable to profits tax.

7. The Commissioner refers to the well-settled principle that in determining whether an asset was acquired as a capital asset or trading stock, the taxpayer's intention at the time of acquisition is crucial. The professed intention of the Taxpayer is not conclusive and all the surrounding circumstances have to be considered to see if the stated intention was, on the evidence, genuinely held, realistic or realizable. There can be no dispute about such principle and it is not necessary for us to refer to the case law on this.

8. The Commissioner relies on the following main matters in submitting that the Taxpayer purchased the Property with the intention of resale for profit :

- (i) The Taxpayer and her mother never resided at the Property. In fact, it was agreed to be sold by her even before the assignment of the Property to her.
- (ii) After selling the Property in 2004, the Taxpayer has not purchased or rented another property as a residence for her mother and herself. They continue to live at Property G.

9. The Commissioner also argues that the explanations offered by the Taxpayer as to her conduct are not capable of belief in light of the circumstances which will be dealt with later.

The case of the Taxpayer

10. The main points in the evidence of the Taxpayer can be summarized as follows :

- (i) The reason why she acquired Property G in 1997 was that she qualified for Government housing allowance in that year.

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- (ii) Furthermore, the property in District H which was owned by her father was getting quite old.
- (iii) She purchased Property G as a residence for her mother and herself and they actually moved there in 1997. The location is very convenient both in respect of shopping and access to public transport.
- (iv) After having stayed in Property G for about two years, they, especially her mother, discovered that it was not such an ideal home for the reason that there was a lot of air and noise pollution and that it was very cold in winter and hot in summer because it was facing north-west. Her mother subsequently expressed the wish that they should move to another place.
- (v) In 2002, after looking at some properties, she eventually located the Property (still under construction) which she thought would be suitable as a residence for her mother and herself for the following reasons :
 - (a) The size was right.
 - (b) It was facing south-east.
 - (c) It was quiet and there was no air pollution.
 - (d) It had three bedrooms plus a proper servant's room – it was her intention to employ a domestic helper.
 - (e) It was convenient because of the MTR station nearby.
- (vi) She truly intended to use the Property as a residence for her mother and herself when it was completed and had no intention of re-selling it for profit.
- (vii) In support of her contention that she intended to hold the Property long term, she relies on the following facts :
 - (a) she made a down-payment of 30%;
 - (b) she especially arranged with the bank mortgagee for bi-weekly repayments to be made, so that the interest payable would be less;
 - (c) she chose to pay the stamp duty in the sum of over \$130,000 immediately as opposed to leaving it till completion.

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- (viii) At the time of the purchase, she knew there could not be a direct and convenient access to the MTR station nearby because there were hoardings on site but she was expecting the same to be removed by the time of completion.
- (ix) In or about late 2003 or early 2004, as the relevant part of the project was near completion, she discovered that the direct and convenient access to the MTR station would not be ready in the near future. In fact, it looked to her that it was unlikely to be available for some considerable time. The way to travel from the Property to the MTR station would be by shuttle bus.
- (x) In the meantime, her mother was suffering from a painful knee.
- (xi) The Taxpayer then began to think that her mother and herself would have to suffer great inconvenience if they were to move to the Property on completion. She would not know whether to leave it vacant or to rent it out pending the availability of the direct and convenient access to the MTR station.
- (xii) She was also worried about having to show potential purchasers the Property if she were to sell it after completion, because she would not feel safe to leave the key to the Property with estate agents.
- (xiii) She therefore started to market it through estate agents and eventually sold it before completion.
- (xiv) Ever since then, she has been looking for a suitable alternative property to buy as a residence for her mother and herself but without success. One of the reasons why she failed to purchase another property was that the prices of properties were generally going up to unrealistic levels.
- (xv) Hence, she and her mother are still stuck in the same place, although they are still searching for a suitable property. They have in mind a project in District H vicinity called 'XXXXXX' which, however, has not yet been marketed.
- (xvi) In further support of her contention that she did not intend to purchase the Property for resale for profit, she says that she is an extremely conservative investor. She had never bought any stocks and shares except in 2004 when she bought 1,600 [YYYY] shares which she is still keeping. She keeps all her savings as fixed deposits in the bank to the tune of a few million dollars.

Findings by the Board

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11. Although the members of the Board had formed the preliminary view on paper that this was just another case of a trader in real property not wishing to pay profits tax on the profit made out of a transaction, after hearing the Taxpayer give oral evidence on oath, the Board has come to the conclusion that she can be believed.

12. To begin with, she gave her evidence in a straightforward and forthright manner. She did not try to exaggerate her case when she had the opportunity to do so. To give an example, the documentary evidence shows that her mother was born in 1928. When the presiding Chairman casually asked her whether her mother was aged 78 years, she readily and without hesitation said that her mother was actually aged 74 years because she had exaggerated her age by 4 years when she applied for her Hong Kong Identity Card. It would have been to her advantage if her mother were of a more advanced age.

13. The crux of the Taxpayer's reason for wanting to sell the Property was that she was worried about the great inconvenience which her mother would have to suffer because of the hoardings and the big detour which they would have to take by shuttle bus in order to get to the MTR station.

14. One of the points taken by the Commissioner is that the Taxpayer should have realized from a reading of the developer's brochure that the hoardings might not be removed even on completion of the part of the project where the Property was. We do not think that such a prospect was clear at all from a reading of the brochure.

15. Another point taken by the Commissioner is that the Taxpayer should have made enquires with the developer as to when the hoardings would be removed and the direct link to the MTR station could be used. The Taxpayer's answer was that one look at the site condition would make it obvious that it was not going to happen for a long time and, secondly, one could not really expect the developer to give a very helpful answer in view of the fact that some units in the project were still unsold. We find her answer convincing.

16. As regards the health condition of the Taxpayer's mother, she has produced a report by Dr I, a well-known orthopaedic surgeon, dated 5 June 2006. He refers to consultations by the mother regarding her right knee pain on 3 May and 16 October 2003. According to the Taxpayer, her mother was given three jelly-injections by Dr I in the knee. No more injections were made on the advice of Dr I. He saw her again on 25 April 2006 for back pain. In 2003, the Taxpayer had of course not agreed to sell the Property. We get the impression from the evidence of the Taxpayer that whilst her mother had pain in the knee, it was not serious to the extent that she was incapacitated from walking. We accept her evidence that it would have been very inconvenient for her mother to have to wait for the shuttle bus in the car park, climb into it and later climb out again and then walk the remaining distance to the MTR station. Furthermore, we do not think that the medical report was contrived because the Taxpayer could have contrived a lot more medical evidence, for the period between 2004 and 2006 if she had intended to.

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17. We should add that we do not rule out the possibility that, in deciding to sell the Property, the Taxpayer was also affected to a certain extent by the increase in the value of the Property which had already been achieved by that time. This however strictly has no bearing on her original intention.

18. We also accept the Taxpayer's evidence that one of her reasons for not having succeeded in purchasing another property in the meantime is that prices had subsequently reached an unrealistic level.

19. We have also taken into account the following points which seem to support the Taxpayer's allegations :

- (i) She made a down-payment of 30% and arranged for a relatively short-term mortgage with bi-weekly repayments for the Property. This would seem to be highly unusual for a purchaser of property who was thinking of selling the property within a short time for profit.
- (ii) She has displayed a very conservative mode of investing her money.
- (iii) She did sign an employment contract to employ an Indonesian domestic helper in February 2006. Presumably, the process leading up to this would have commenced some time before that.

20. We do not think that there is much in the points made by the Commissioner that the Taxpayer's instruction to the estate agent was dated 1 January 2004 and that she did not leave her claim for deduction for home loan interest for the year of assessment 2002/03 over so that she would be able to claim a larger deduction later. We accept the Taxpayer's explanation.

21. All in all, we accept the Taxpayer's evidence that, when she acquired the Property, her intention was to keep it on a long term basis and use it as a residence for her mother and herself.

22. In her submission, the Taxpayer has criticized the Inland Revenue Department for not accepting her explanation earlier and doing more investigation. We take the view that such criticism is unwarranted and unjustified. On paper, anybody would be justified in taking a suspicious view of all the circumstances prevailing in this case.

Conclusion

23. We hold that the Taxpayer has discharged her burden of proof under section 68(4) of the IRO and proved that she did intend to acquire the Property as a capital asset.

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24. We therefore allow her appeal and overrule the determination of the Commissioner. In the result, she is not assessable to Profits Tax in relation to the purchase and sale of the Property.