Case No. D63/98

Profits tax – real property – usage – whether liable for profits tax.

Panel: Terence Tai Chun To (chairman), Kenneth Chow Charn Ki and Emily Lam Yuet Ming.

Date of hearing: 12 May 1998.
Date of decision: 22 July 1998.

In May 1991 the taxpayer purchased the subject property and sold it in July 1993 The taxpayer claimed that the unit was for self-occupation. The subject property had been used by the taxpayer as a holiday resort.

Held:

(1) Declarations of self-use or self-residential use are sufficiently clear to embrace the use of the subject property as a holiday resort by the taxpayer.

Appeal allowed.

Tsui Siu Fong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

This is an appeal by the Taxpayer against a profits tax assessment for the year of assessment 1993/94 wherein the gain on the disposal of a property was subjected to tax.

Background facts:

(1) The Taxpayer has objected to the profits tax assessment for the year of assessment 1993/94 raised on him. The Taxpayer claims that the profit he derived from the sale of a property was not chargeable to profits tax.

(2) During all relevant times the Taxpayer was married and had three children who were born in 1986, 1988 and 1990 respectively. He was employed as a housing officer in the Hong Kong Government. His family resided at the staff quarters in District X which

was provided to him by his employer. The Taxpayer derived the following income during the years ended 31 March 1992 to 31 March 1994:

	Income
	$
Year ended 31-3-1992	239,644
Year ended 31-3-1993	278,101
Year ended 31-3-1994	306,120

(3) By agreement for sale and purchase dated 15 May 1991 the Taxpayer purchased the property at District Y ('the Subject Property') at a price of $1,048,900. The size of the Subject Property was 597 square feet. At the time of purchase, the Subject Property was still under construction. To finance the purchase, the Taxpayer obtained a loan of $770,000 from the bank which was to be repaid by 120 monthly instalments of $10,178.40 each. The terms of the repayment were subsequently changed to 180 monthly instalments of $7,575.06 each, effective from January 1992. The occupation permit for the Subject Property was issued on 2 November 1992. The purchase was completed on 18 December 1992 when the Subject Property was assigned to the Taxpayer.

(4) By agreement for sale and purchase dated 23 July 1993 the Taxpayer sold the Subject Property for $1,700,000. The sale was completed on 20 August 1993 when the Subject Property was assigned to the purchasers.

(5) In January 1994 the Taxpayer and his wife purchased Property Z in District Y at a price of $2,000,000. The Property Z had a size of 683 square feet. The Taxpayer couple sold this property for $2,270,000 in April 1996.

(6) In response to the assessor's enquiries, the Taxpayer asserted, among other things, the following:

(a) **The Subject Property**

(i) Intended usage or actual usage: 'Self-occupation'

(ii) Reasons for selling:

'1. occupation rate very low (too isolated)

2. too small

3. traffic inconvenience'

(iii) Change of residence: Property Z

(iv) Profit on disposal:

	$	$
Selling price		1,870,000
Less: Purchase cost		1,048,900
Gross profits		821,100
Less:		
Legal fees on purchase	35,000 (appro.)	
Stamp duty	5,000 (appro.)	
Bank interest	130,000 (appro.)	
Decoration	5,000 (appro.)	
Legal fees on sale	25,000 (appro.)	
Commission to agent on sale	18,700 (appro.)	218,700
Net profit		602,400

(b) **The Property Z**

(i) Intended usage or actual usage: "Occupied by a friend without tenancy agreement"

(ii) Reasons for selling:

'1. financial hardship

2. unable to afford to repay for this property'

(7) The assessor was of the view that the purchase and sale of the Subject Property by the Taxpayer amounted to an adventure in the nature of trade. On 16 July 1997 he raised the following profits tax assessment for the year of assessment 1993/94 on the Taxpayer:

	$
Estimated Assessable Profits	700,000
Tax Payable thereon	105,000

(8) The Taxpayer objected to the assessment on the ground that he bought the Subject Property solely for self residential use which involved no element of business, trade or speculation. He further claimed the following:

> 'The date of purchase was May 1991 and that of sale was July 1993. The long period (2 years 2 months) of holding the property proved that I was a genuine user rather than an adventurer. Moreover, I have never held more than one property at any same time.'

(9) In reply to the assessor's enquiries, the Taxpayer claimed that:

(a) The Subject Property had been used by him as a holiday resort.

(b) He replaced the Subject Property by Property Z because the latter property was bigger and more centrally located with better traffic facilities. He also used Property Z as his holiday resort.

(c) No documentary evidence was available for the decoration expense and the receipt for the commission to agent on sale had been lost. He adduced copies of the following documents to support other expenses allegedly incurred by him on the Subject Property:

(i) Debit advices issued by the bank which showed that he had paid loan interests totalling $126,746 on the Subject Property;

(ii) A debit note and a receipt issued by Messrs Winston Chu & Co which showed that he had paid solicitor's fee of $2,240 on purchase of the Subject Property;

(iii) Fee note issued by Messrs Tony Kan & Co which showed that he had paid solicitor's fee of $8,000 on sale of the Subject Property;

(iv) Electricity bills showing the following particulars:

Reading date	**Units consumed**	**Electricity charge ($)**
8-1-1993	30	20
5-3-1993	40	27
1-4-1993	30	21
5-8-1993	71	49
		117

(10) The assessor is now of the opinion that the profits tax assessment for the year of assessment 1993/94 should be revised as follows:

	$	$
Gross profits per computation in Fact (6)(a)(iv)		821,000
Less:		
Stamp duty	5,000	
Expenses per Fact (9)(c):		
Loan Interests	126,746	
Legal fees ($2,240 + $8,000)	10,240	
Electricity charges	117	142,103
Revised Assessable Profits		678,997
Tax Payable thereon		101,849

(11) The Taxpayer gave evidence at the hearing.

(12) He stated that he bought the Subject Property for his own use which should be construed to include the use as a holiday resort by him and his family.

(13) The Subject Property was about 10 minutes drive away from the staff quarters.

(14) There were a playground and a beach in the vicinity of the Subject Property, which were open to the public.

(15) The Taxpayer and his family paid regular visits to the playground and the beach during weekends and public holidays and derived considerable joy in watching the holiday resort coming closer to reality as the work progressed.

(16) The Revenue queried the actual use of the Subject Property as a holiday resort since there was neither decoration nor furniture in the Subject Property.

(17) The Taxpayer's answer was that the developer of the Subject Property had a reputation for providing adequate amenities in all its properties including the Subject Property. There was no need to have the Subject Property decorated. And since the Taxpayer and his family never spent the night in the Subject Property, which incidentally explained the low consumption of water and electricity in the Subject Property, there was no real need for furniture to be installed there.

(18) In the Taxpayer's letter to the Revenue dated 14 October 1997, the Taxpayer stated that he intended to use the Subject Property as a holiday resort. Previously, the Taxpayer declared that he bought the Subject Property for self-occupation or self-residential use.

(19) The Revenue was not happy with the apparent inconsistency.

(20) We would have thought that declarations of self-use or self-residential use were sufficiently clear to embrace the use of the Subject Property as a holiday resort by the Taxpayer. To interpret otherwise would be hairsplitting.

(21) The Taxpayer further stated that in May 1991 he made a down payment of $280,000 for the purchase instead of the usual 10% deposit.

(22) Initially, the Taxpayer financed the purchase by a bank loan of $770,000 repayable by 120 monthly instalments of $10,178.40 which were subsequently changed to 180 monthly instalments of $7,575.06.

(23) The Taxpayer completed the purchase in December 1992.

(24) The Taxpayer sold the Subject Property in July 1993, that is, 2 years and 2 months after he entered into the sale and purchase agreement in respect of the Subject Property or 8 months after taking possession.

(25) The Taxpayer submitted that his substantial deposit payment was not characteristic of a speculator who would usually pay only the minimum of deposit.

(26) It was urged by the Revenue that the Taxpayer was not financially capable of holding the Subject Property long term as evidenced by the Taxpayer's decision to reduce his monthly instalment payments from $10,178.40 to $7,575.06 and his application for a bank overdraft.

(27) The Taxpayer submitted that it was precisely because of his determination to keep the Subject Property for long term purpose that he undertook to amend his financial arrangements. After all, he could have sold the Subject Property for a profit if he were a speculator and that would relieve him of all financial anxieties.

(28) We are impressed with the Taxpayer's testimony and we are satisfied that he was not financially incapable of holding the Subject Property long term.

(29) As to the reason for selling the Subject Property, the Taxpayer submitted that he wanted to exchange the Subject Property for Property Z.

(30) According to the Taxpayer, Property Z was better suited because it was bigger, the location more centrally located and traffic more convenient.

(31) The Taxpayer acquired Property Z in January 1994.

(32) He disposed of Property Z in April 1996, more than two years later.

(33) For most of the time of his ownership of Property Z, the Taxpayer allowed his friend to live there. Although the Taxpayer did not ask his friend to pay rent, his friend made intermittent payments to the Taxpayer varying from $7,000 to $9,000 each time. The Taxpayer's property tax returns for the year of assessment 1995/96 disclosed that he had received a total of $43,500 in respect of Property Z.

(34) The Taxpayer's friend left Property Z as promised after staying there for slightly more than a year.

(35) By this time, the Taxpayer's financial commitments increased as his children were growing up.

(36) Much as he would like to, the Taxpayer found it difficult to hold on to Property Z.

(37) So, after more than two years' ownership, the Taxpayer sold Property Z.

(38) It was common ground that the Taxpayer did not hold more than one property at a time. Further, notwithstanding the Revenue's previous argument to the contrary, it has now appeared to be beyond dispute that the Taxpayer had held on to the Subject Property for 2 years and 2 months before selling it. It is true that these facts in isolation are not conclusive in establishing that the Taxpayer intended to hold the Subject Property long term but taken together and with the other evidence of the case these facts are far more consistent than not with the Taxpayer's testimony that he acquired the Subject Property as a long term investment.

(39) Having regard to all of the circumstances and the forthright manner in which the Taxpayer gave evidence, we are satisfied that the Taxpayer is an honest witness and that he has discharged the onus of showing that he purchased the Subject Property with the intention of holding it on a long term basis. We would therefore allow the Taxpayer's appeal and discharge the assessment accordingly.