

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D64/87

Profits tax – purchase and immediate resale of flat – whether profits were trading gains or realization of capital – s 14 of the Inland Revenue Ordinance.

Panel: Henry Litton QC (chairman), Pong Fai and W I Cheung.

Date of hearing: 24 February 1988.

Date of decision: 9 March 1988.

The taxpayer was a civil servant who lived in a rented flat for which he received a tenancy allowance from the government. He was concerned about rising rents. He learned that the government would shortly introduce a home purchase scheme for civil servants which would enable him to afford to buy the flat. In anticipation of such a scheme, he entered into a contract to buy the flat. At that stage, he had no intention to resell the flat. However, the home purchase scheme did not come into effect. Faced with the prospect of losing his tenancy allowance if he lived in a flat which he owned, he resold the flat at a profit immediately after completion of his purchase.

The Commissioner assessed these profits, claiming that the taxpayer had engaged in an adventure in the nature of trade by buying and reselling the flat.

Held:

The profits were not assessable.

The taxpayer's activities were not of a sufficiently commercial nature to be treated as an adventure in the nature of trade.

Appeal allowed.

Cases referred to:

Clark v Follett (1973) 48 TC 677

Turner v Last (1965) 42 TC 517

J G A Grady for the Commissioner of Inland Revenue.

The taxpayer in person.

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### Decision:

1. This appeal is concerned with an estimated assessment made on the Taxpayer for the year of assessment 1979/80 in the sum of \$145,000. This profit arose from the sale of a flat ('the flat') and a car parking space of a building in Kowloon ('the building'). The transaction took place as long ago as November 1979. The assessment, against which the Taxpayer now appeals, was made on 27 February 1986.

### Background facts

2. The Taxpayer is a civil servant. In 1979 the Taxpayer was living with his family in the flat. He was at that time drawing a private tenancy allowance. This was an allowance which the Hong Kong Government provided for civil servants of a certain rank. By such allowance, a substantial contribution is made by the Government towards the rent paid by the civil servant for his domestic accommodation. A number of other civil servants also lived in the building.

3. 1979 was a time when inflation in the real estate market in Hong Kong was running high. The capital value of flats was rising rapidly, and so was the rent required to be paid by tenants. This benefited the owners of real estate, but put enormous pressure on those having to pay rent for their flats.

4. Some time prior to July 1979 the Taxpayer and his co-tenants in the building heard rumours that the landlord was proposing to terminate all the tenancies in the building (or not to renew them) and they were much concerned. At about the same time the Taxpayer and his colleagues came to know that the Governor-in-Council had approved a set of principles and guidelines governing the provision of assistance towards housing for civil servants and in particular a new Home Purchase Scheme. The Taxpayer felt that his interests, and those of his colleagues, would be advanced if he took an active part in the affairs of an association of civil service employees which existed for the purpose of advancing members' interests ('the Association'). In this way, the Taxpayer and his colleagues would have more direct access to information concerning the Government's policy regarding housing allowances for civil servants. In July 1979 a number of civil servants in the Department in which the Taxpayer was then serving nominated the Taxpayer to represent them in the sub-committee for housing policy of the Association.

5. On 15 August 1979 the Director of Public Works issued a circular and enclosed a consultative paper setting out the details of the new proposals for housing assistance to civil servants, including proposals for the new Home Purchase Scheme. The consultative paper stated that the home purchase allowance would replace the present forms of housing allowances: that is, allowance for non-departmental quarters and private tenancy allowance. There is no evidence before us as to when precisely the Taxpayer or his colleagues first had sight of this consultative paper, but it would seem reasonable to infer that he saw it within a reasonably short time, since it was intended to apply to officers of his rank.

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6. In August 1979 the Taxpayer received a notice, given on behalf of the owners of the building, that the flat was available for sale to him (subject to contract) for \$1,011,350 excluding the cost of the car park. If interested, the Taxpayer was required to return the confirmation slip on or before 31 August 1979, on receipt of which arrangements would be made for a formal offer to be forwarded to him.

7. It is what followed the notice of August 1979, and the steps taken by the Taxpayer pursuant thereto, that gave rise to the matters in dispute in this case.

### 'Adventure in the nature of trade'

8. It is the contention of the Commissioner that, following the notice of August 1979 by the owner's agent offering to sell the flat to the Taxpayer, the Taxpayer embarked upon an adventure in the nature of trade.

9. Generally speaking, the fact that a property is purchased and immediately re-sold does not, of itself, give rise to an inference of trade, particularly when the property is the home of the Taxpayer. The expression 'trade or business' in section 14 of the Inland Revenue Ordinance connotes transactions with a commercial flavour. What section 14 of the Inland Revenue Ordinance is aimed at are the profits arising from a trade or business which has been carried on. Mr Grady, on behalf of the Commissioner, says that in this case the Taxpayer had intended at the outset to sell the property; when he indicated his interest to purchase the property, in response to the notice of August 1979, and when he actually committed himself to purchase the property, the only intention he had in his mind at the time was to sell. He relied upon the cases of Turner v Last (1965) 42 TC 517 and Clark v Follett (1973) 48 TC 677 as illustrating the point that where a taxpayer intended at the time when he purchased a property to sell it and did so almost immediately after his purchase, then the inference that he was carrying on a trade becomes irresistible.

10. For us to determine this matter we must look more closely into the circumstances surrounding the purchase and re-sale.

### Circumstances of purchase and re-sale

11. In answer to the notice on behalf of the owners of August 1979, the Taxpayer on 29 August 1979 returned the confirmation slip to the owner's agent indicating his interest in purchasing the flat at the price of \$1,011,350 and inviting a formal offer to be made.

12. In September 1979 the Taxpayer signed a document entitled 'Confirmation of Instruction', paid a deposit of \$10,000 for the purchase of the flat and agreed to pay instalments as follows:

\$141,702.50 to be paid on the signing of the formal sale and purchase agreement at the solicitors' offices;

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\$151,702.50 to be paid on or before 24 December 1979; and

\$707,945 to be paid on completion of the sale and purchase on or before 15 July 1980.

13. In his testimony before us, the Taxpayer said that, at the time when he paid the \$10,000 deposit and committed himself to purchase the flat, he expected the Home Purchase Scheme to have been implemented in time to relieve him of the financial burden of having to pay the final instalment of the purchase price amounting to approximately 70%. This was challenged by Mr Grady in cross-examination. It was pointed out that the consultative process, to the knowledge of the Taxpayer, was not going to be completed until the end of October 1979, and that it was therefore unrealistic to think that the Home Purchase Scheme was going to be implemented in time to enable the Taxpayer to be personally relieved of any part of his obligations for the purchase price amounting to over \$1,000,000. (As matters transpired, the proposals did not in fact receive the approval of the Executive Council and Finance Committee until June and July 1981.)

14. As we view the evidence, the proposals when they were first put to the staff side of the Senior Civil Service Council in July 1979 had reached a mature stage. The scheme and the guidelines had already been approved in principle by the Governor-in-Council. Hong Kong was then undergoing rapid development and change and the pressure on accommodation was very severe. Whatever might have been the eventual outcome of the proposals, there was no reason why someone in the Taxpayer's position should not have believed, in about September 1979, that the Home Purchase Scheme would have been in place by the beginning of the next financial year, in time to benefit him at least with regard to the bulk of his financial obligation for the purchase. We accept that the Taxpayer was telling the truth in his testimony on this point.

15. Although the Confirmation of Instruction dated September 1979 required the purchaser, within 14 days, to attend at the solicitors' offices to sign the formal sale and purchase agreement, in fact this was not done. The Taxpayer told us in his evidence that he received notification to the effect that he would be told when to attend to sign the sale and purchase agreement and pay the instalment of \$141,702.50. We accept his evidence on this point.

16. The Taxpayer stated in his evidence that, soon after it became known that the owners were offering to sell the flats in the building to the sitting tenants, he and the other tenants of the building received a number of offers from agents to purchase the flats. They got telephone calls, and messages were left in their letter-boxes and at their doors. Considering the state of the real estate market at that time, this does not seem to us improbable.

17. The Taxpayer asserted in his testimony that he fully intended to pay, out of his own resources, the first and second instalments of the purchase price. He was challenged on

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this in cross-examination, and he explained that he had a brother who was reasonably well off, from whom he could borrow; his wife worked in a bank at the time and was able to borrow a certain amount from the bank for the purpose of home purchase; and he also had some personal savings. He would thus have been able to pay the first two instalments. We accept his testimony on this point.

18. In our view, when the Taxpayer paid the deposit of \$10,000 in September 1979, and agreed to purchase the flat, he had no intention to sell. It was after all his home, and sale obviously meant a considerable upheaval for him and his family. As regards committing himself to a purchase involving an outlay of more than \$1,000,000, the Taxpayer was probably not too anxious about that because he knew that he was purchasing a flat which, if the worse came to the worst, he could sell in the market for more than the purchase price. Assuming this possibility to have been in his mind (and we infer from the circumstances of the case and, in particular, from the way he answered the questions in cross-examination concerning his ability to pay that such possibility was real), this does not mean that the Taxpayer had embarked upon an adventure in the nature of trade. In our view, the dominant factor in his mind at the time of the purchase was the prospect of the Home Purchase Scheme and it was the coincidence in time of the announcement of the proposals together with the offer to purchase his own flat which largely prompted him to accept the offer in the first place.

19. In his testimony before us, the Taxpayer was extremely vague as to when he came to realise that the Home Purchase Scheme was unlikely to be put in place in the immediate future. However, there is no material before us to lead us to think that he was not telling the truth when he asserted that he learned of this sometime before November 1979 (but after September 1979). We accept that with the long lapse of time recollections of events would become vague.

20. In October 1979 the Taxpayer was elected by the members of the Association at its annual general meeting to serve on the council (its governing body). Thus the Taxpayer was in a position to get a better feel for the Government Secretariat's policies. It is probable that sometime after his election he came to realise that the Home Purchase Scheme was unlikely to be implemented in the near future.

21. The Taxpayer asserted that the realisation that the Home Purchase Scheme was unlikely to benefit him with regard to the purchase of the flat placed him in an awkward position. His understanding was that, so long as the sale and purchase of the flat had not been completed, he would be regarded as a tenant for the purpose of drawing the private tenancy allowance, but that once he had become the legal owner of the flat upon completion of the sale and purchase he would no longer be qualified to draw the private tenancy allowance. His assertion is that these were the reasons which prompted him to sell the flat at about the same time as the signing of the formal sale and purchase agreement. His testimony in this regard was challenged by Mr Grady. It was pointed out by Mr Grady that, at that point, the Taxpayer's only commitment was in respect of the \$10,000 deposit; the receipt issued to the Taxpayer for the \$10,000 deposit stated that it was 'subject to contract';

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and the Taxpayer could therefore have quite lawfully declined to proceed with the purchase when he realised that the Home Purchase Scheme was likely to be delayed. In our view, this is a rather unrealistic view of the matter. There was no merit in the Taxpayer cancelling the transaction, forfeiting the deposit and remaining in the flat as a tenant for a few more months. He had, on 30 August 1979, received formal notice to quit and was required to deliver vacant possession of the flat on 31 August 1980; he knew, sooner or later, that he had to vacate the flat. Given the opportunity of a considerable gain by a re-sale of the flat, we see no reason why the Taxpayer should not have grasped the opportunity.

22. We should add that we are not wholly convinced that the prospect of the Home Purchase Scheme, and then realisation of its unavailability, were the only factors which motivated the Taxpayer in the purchase and subsequent re-sale in this case. It was undoubtedly a factor; but another factor was the knowledge that he was offered the opportunity of buying the flat at a favourable price, in a rising market. When he realised that Government finance was unlikely to be available to assist him in paying the balance of 70% on completion, he made the decision to sell. Had the Home Purchase Scheme been in place in November 1979 (or its implementation been assured by July 1980) we feel sure that the Taxpayer would have completed the purchase.

### Conclusion

23. In our view, there were no activities of a commercial nature in this case which could properly characterise the purchase and re-sale of the flat as an adventure in the nature of trade.

24. The appeal is allowed and the estimated assessment made by the assessor, as confirmed by the Commissioner, is discharged.