INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D65/89

Profits tax – purchase and sale of a residential apartment – whether property trading or property investment.

Panel: William Turnbull (chairman), Graeme Large and Raymond J Faulkner.

Date of hearing: 17 August 1989.
Date of decision: 26 October 1989.

The taxpayer was a company owned by a business woman. The business woman heard that the property in which she was living was likely to be redeveloped and caused the taxpayer company to purchase a flat in a neighbouring building. It was the intention of the business woman to use the flat purchased by the taxpayer company as her future residence. Owing to a change of intention, the taxpayer sold the flat at a profit.

Held:

The taxpayer company was neither trading in property nor entering into a venture in the nature of trade and accordingly the profit or gain was of a capital nature and not subject to profits tax.

Appeal allowed.

Pauline Fan for the Commissioner of Inland Revenue.
Stephen W T Liu of Stephen Liu & Co for the taxpayer.

Decision:

This is an appeal by a limited company against an assessment to tax of a profit or gain realised on the sale of a residential apartment.

The facts are as follows:

1. The Taxpayer company was incorporated in June 1979 with an issued and fully paid up capital of two shares of $10. In its first profits tax return for the year of assessment 1979/80 the Taxpayer company described the nature of its business as ‘property investment’. It continued to describe its business as ‘property

investment' for the years of assessment 1980/81 and 1981/82. From 1982/83 onwards it described its business as 'inactive'.

2. The Taxpayer company was at all material times owned by a business woman, Ms X, who acquired the Taxpayer company for the sole purpose of purchasing a residential apartment.

3. Ms X lived in a rented apartment ('apartment A') in a compound comprising three comparatively old apartment blocks. She liked the environment. She had lived in the same apartment for some years and enjoyed rent protection and security of tenure under the landlord and tenant legislation. In April 1979 her tenancy was due for renewal and was duly renewed for a period of two years commencing on 1 April 1979 at a monthly rental of $3,100.

4. At about the same time as she renewed her tenancy or shortly thereafter she heard rumours which were circulating amongst other tenants in the building in which her apartment A was situated that the landlord proposed to redevelop the building. This caused her concern because she believed that the landlord could force her to vacate apartment A by paying her compensation. As she was fond of the environment she did not wish to move elsewhere.

5. Her landlord only owned one of the three apartment blocks in the compound and the other two blocks were individually owned by a number of owners. It came to the attention of Ms X that one apartment ('apartment B') in one of the other two blocks was for sale. Acting on the rumours which she had heard she decided to purchase apartment B which was for sale in case her landlord were to force her to vacate apartment A which she was renting.

6. Ms X acquired the Taxpayer company specifically for the purpose of acquiring apartment B and the Taxpayer company acquired apartment B on 30 June 1979. The Taxpayer company financed the acquisition of apartment B partly by a loan of $599,034 from Ms X and the balance by way of an instalment loan from a bank. The rent received by the Taxpayer company from the first of its two tenancies was insufficient to meet the interest payable to the bank but the rental from the second of its two tenancies exceeded the amount of the interest payable to the bank. Though no specific evidence was given in this regard it was apparent that the Taxpayer company with the assistance of its sole owner, Ms X, had the financial resources available to it to meet the instalments payable to the bank of both interest and repayment of capital because during the sixteen months period when it owned the apartment it apparently had no difficulty in meeting its periodic payments to the bank.

7. Ms X continued to live in apartment A which she rented. After acquiring the Taxpayer company and apartment B, she proceeded to cause the Taxpayer company to rent out apartment B, first for the two months of July and August

1979 at a rent of $9,500 per month to its previous owner and then for a period of twelve months to a new tenant at a rent of $14,500 per month.

8. Shortly before the tenancy agreement of the Taxpayer company's apartment B was due to expire at the end of August 1980, Ms X made enquiries of a firm of architects who had been instructed by her landlord regarding the proposed redevelopment of the apartment block in which she resided. She was told that her landlord had decided not to proceed with the proposed redevelopment because of the very large premium which it was anticipated the Government would charge for permitting the redevelopment. At the same time the tenant occupying apartment B owned by the Taxpayer company indicated to the Taxpayer that the tenant did not wish to renew the tenancy agreement and would surrender to the Taxpayer company vacant possession at the end of August 1980.

9. As Ms X no longer feared that she might be forced to vacate apartment A which she occupied and as apartment B owned by the Taxpayer company was vacant or about to be vacant, Ms X decided to cause the Taxpayer company to sell apartment B which it owned. Apartment B was sold in November 1980 for $3,050,000 and a net profit or gain was realised of $1,518,715.

10. Ms X has continued until the present time to rent apartment A which she was then occupying but now lives in another part of the Territory. Apartment A which she continues to rent is used for occupation by persons connected with her business.

11. The proceeds of sale of apartment B owned by the Taxpayer company were used to pay off the balance of the bank loan which the Taxpayer company had obtained when it purchased apartment B and the balance representing the initial deposit paid by the Taxpayer company and the net profit or gain were paid to Ms X to enable her to acquire a residential property in the United Kingdom to support an application for residence which she was then making to live in the United Kingdom.

At the hearing of the appeal the Taxpayer company was represented by Ms X who also gave evidence and was cross-examined. We accept the truth of the evidence which she gave. She submitted on behalf of the Taxpayer company that the profit or gain on sale of apartment B was of a capital nature based on the facts which she had given to the Board in her evidence. She submitted that this was a one off transaction and that neither she nor the Taxpayer company had any intention of carrying on property trading or a venture in the nature of trade.

The representative for the Commissioner submitted that a mere declaration of intention by the Taxpayer company or its controlling shareholder and director is not sufficient. The representative for the Commissioner pointed out that Ms X already had a

place of residence where she could live and that she had just entered into a two year tenancy agreement so that it was not necessary for her to look for alternative premises in which to live. It was pointed out that apartment B which was purchased was in the same compound as the apartment building which was under threat of demolition and that the Taxpayer company had no activities other than this one property transaction.

It was further submitted on behalf of the Commissioner that taking into account all of these factors it is difficult to accept that the true intention of the Taxpayer company in acquiring apartment B was to use it as a place of residence for its director. It was pointed out that the issued capital of the Taxpayer company was only $20, that the Taxpayer company did not lease out apartment B on a long lease as it was submitted should have been the case if it intended the apartment to be a long term investment. It was submitted that there was no evidence to demonstrate that it was commercially realistic for the Taxpayer company to acquire the apartment as a long term investment and that the Taxpayer company sold apartment B which negated the suggestion that the Taxpayer company intended to hold apartment B as a long term investment.

With due respect to the representative for the Commissioner we find on the facts in favour of the Taxpayer company. In reality the Taxpayer company was no more than an extension of its owner and director, Ms X. If Ms X had acquired apartment B in her own name we would have no hesitation in finding that this was not a property trading transaction nor was it a venture in the nature of trade. We accept that the reason for purchasing apartment B was because Ms X feared that she would be forced to vacate apartment A which she was then occupying and wished to continue to live in the same compound. We likewise accept that the uncertainty relating to apartment A which she was occupying disappeared and that it was reasonable for her to sell apartment B which she had purchased in the name of the Taxpayer company. The submission on behalf of the Commissioner that the Taxpayer company should have leased out apartment B for a long period and not for a short period is not logical. The whole intent of Ms X in acquiring apartment B was to enable herself to live there. If she had caused apartment B to be leased to a third party for a long period of time it would have totally frustrated her intention. Likewise we find no substance in the submission that the Taxpayer company was trading because it only had a nominal capital. In a situation such as the present, the issued share capital of the Taxpayer company is irrelevant. The question to be asked is whether or not the Taxpayer company had the ability to acquire and hold the apartment. This it obviously did with the assistance of its shareholder and director, Ms X.

As we say, if Ms X had acquired apartment B in her own name we would have no hesitation in deciding that the profit or gain on the disposal of apartment B was not taxable. The question which we must then consider is whether the fact that Ms X used a company for her purposes makes any difference. The answer is that in this case it did not. Ms X was not a property developer or property trader and this was not one of many companies or transactions carried by her. It was an isolated transaction which she carried out for a specific purpose and that purpose had no relationship to trading or a venture in the nature of trade. For all intents and purposes the Taxpayer company was in the same position

as Ms X. The thoughts, wishes and decisions of Ms X were those of the Taxpayer company. We have no evidence before us to suggest anything to the contrary. It was not put to Ms X in cross-examination that there was any ulterior motive in her using the Taxpayer company to acquire apartment B. Ms X said that the reason for using a company was that she was acting on the advice of her auditors who provided her with the company. The use of a company per se does not make a non-trading activity into a commercial trading transaction.

The representative for the Commissioner also drew our attention to the fact that the Taxpayer company had filed various tax returns and had received various estimated assessments in default of tax returns. It was pointed out that one of the estimated assessments had been accepted by the Taxpayer company and no objection had been filed and it was sought to place weight upon this fact by arguing that it was in some way an admission by the Taxpayer company that it was carrying on property trading business. The evidence given by Ms X was to the effect that the management and accounts of the Taxpayer company left much to be desired and we are satisfied that no inference one way or the other can be derived from the Taxpayer company's bookkeeping and tax affairs other than to substantiate what Ms X said, namely that the affairs of the Taxpayer company were not properly or efficiently handled. This state of affairs would give credence to the Taxpayer company not being a commercial enterprise but only a nominee holding the property for Ms X.

For the reasons given we find that the Taxpayer company was neither trading in property nor entering into a venture in the nature of trade and that accordingly the profit or gain was of a capital nature and is not taxable. The profits tax assessment for the year of assessment 1981/82 against which the Taxpayer company has appealed is remitted back to the Commissioner to be reduced accordingly.