

INLAND REVENUE BOARD OF REVIEW DECISIONS

**Case No. D6/97**

**Profits tax** – sale of property – ability to carry out intention.

Panel: Christopher Chan Cheuk (chairman), Gordon Macwhinnie and William E Mocatta.

Date of hearing: 17 February 1997.

Date of decision: 14 April 1997.

The taxpayers purchased the subject property under construction. They had the choice between two plans of payment. Plan A was for buyers to pay according to construction stages and the balance upon completion. Under Plan B buyers had to commence instalment payments forthwith but the developer agreed to grant loan to be repaid by 240 instalments. The taxpayers were living at rented property which meant that they had to pay both rent and instalment at the same time. The taxpayers chose Plan A. By completion banks had tightened the lending criteria which the taxpayers failed to reach. They decided to sell the property.

Held:

The taxpayers made wrong judgment of the situation and did not choose Plan B. Other evidences showed that their intention to live there was very firm. The taxpayers had the ability to carry out their intention had they not made the wrong choice.

**Appeal allowed.**

Cases referred to:

D32/85, IRBRD, vol 2, 204  
Leeming v Jones 15 TC 333  
CIR v Livingston and Others 11 TC 538  
Simmons v CIR 53 TC 491  
D11/80, IRBRD, vol 1, 374

May Chan for the Commissioner of Inland Revenue.  
Chan Man Lee of Messrs Chan Man Lee & Co for the taxpayer.

**Decision:**

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### **The Appeal**

1. This is an appeal by Madam A and Mr B against the determination made by the Commissioner of Inland Revenue on 18 March 1996 in respect of profits tax assessment for the year of assessment 1993/94. The Commissioner determined the assessable profits to be \$1,591,693 with tax of \$238,753 payable thereon. The profits arose from the purchase and sale of a property by the Taxpayers, that is, the Subject Property.

### **Agreed Facts, Agreed Documents and Testimony**

2. The parties submitted a Statement of Agreed Facts, the contents of which were confirmed by the representatives of both parties.

3. The parties also submitted a bundle of Agreed Documents of 39 pages as agreed evidence.

4. Mr B of the Taxpayers gave evidence and was vigorously cross-examined by Ms May Chan for the Revenue.

5. The issue we have to decide and the Taxpayers had to prove that the transaction did not constitute trading and more precisely in this case that the Subject Property was acquired by the Taxpayers with an intention to reside there.

### **Law**

6. Ms Chan drew our attention to the definition of 'trade' under section 2 of the Inland Revenue Ordinance which states:

*'trade' includes every trade and manufacture, and every adventure and concern in the nature of trade.*

7. She also referred to an obiter in D32/85, IRBRD, vol 2, 211 to demonstrate that a single transaction can constitute trading: 'despite the fact that it dealt with a single transaction nonetheless it was open to the Commissioners to find, if they so believed with reasonable supporting evidence, that it was in the nature of trade.' The case went further to quote a passage in Rowlatt J's judgment in Leeming v Jones which referred to Lord Clyde's decision in the CIR v Livingston and Others: '*the test, which must be used to determine whether a venture such as we are not considering is, or is not, in the nature of trade, is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made.*' The facts in the tax case D32/85 were quite different from those of the present one. The Board has to carefully consider all the evidences before it.

8. Since this is an appeal the Taxpayers are put in a less advantageous position: according to section 68(4) the onus of proof is with the Taxpayers who have to show that

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they acquired the Subject Property not for purpose of trading. This is not an easy burden to discharge.

9. The key issue as set out in Simmons v CIR 53 TC at 491 is: ‘*was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment?*’ Ms Chan urged us to accept that in deciding the issue we should follow the test described in D11/80, IRBRD, vol 1, 374 which states:

“‘Intention’ connotes an ability to carry it into effect. It is idle to speak of ‘intention’ if the person so intending did not have the means to bring it about or had made no arrangement or taken no steps to enable such intention to be implemented.’

### **The ability to pay**

10. To test the Taxpayers’ intention Ms Chan skilfully cross-examined Mr B and tried to demonstrate to the Board:

(a) That the Taxpayers had no intention to reside at the Subject Property because they chose Plan A Standard Payment term where the full balance of listed price (that is, 85%) had to be paid ‘within 14 days of the Purchaser being notified in writing before completion’ instead of choosing Plan B for Immediate Mortgage where the Developer stated with certain amount of assurance that the Developer would assist in making arrangement for mortgage finance at completion. Ms Chan’s proposition for us to consider is that a genuine buyer for his own use would have chosen Plan B because the mortgage loan had been somehow assured by the developer.

and (b) That the Taxpayers were not capable of paying the monthly instalments as it would mean that the whole of their family income would be used for payment of the loan instalment.

11. It was Mr B’s evidence that they did not accept Plan B Standard Payment term because they could not afford to make the repayment instalment and to pay the monthly rent at the same time. The Board finds that it is a reasonable explanation.

12. Mr B further explained that in 1990 they sold a property and earned a profit of about \$900,000, half of which they used to pay the deposits and the remaining half they kept in fixed deposit account. As the completion time was drawing near Mr B approached different banks for mortgage arrangement but was refused as they failed to meet the banks’ lending requirement. The Board accepts his explanation.

13. Mr Chan, Accountant of Chan Man Lee & Co, Certified Public Accountants, for the Taxpayers even projected further and averred that had mortgage loan been granted to his clients, the fixed deposit in their account could assist them in making up their

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deficiencies for a period of four years even if the family income remained the same without increase. Four years would be a good sufficient breathing period for making further arrangement. The Board accepts Mr. B's explanation.

### **The Taxpayers' Case**

14. The Taxpayers' case is relatively simple: in April 1993 they purchased the Subject Property for their own use as dwelling. They found that the location and size of the Subject Property were suitable but did not want to commence instalment payment. They chose Plan A Standard payment term.

15. According to Mr B's evidence which was not challenged, towards the end of 1993 and at the beginning of 1994, the Taxpayers could not find any bank to lend them money; by that time the banks had already tightened their lending criteria in order to help to curb speculation. Being caught in such situation the Taxpayers had to consider other alternatives. They had been approached by estate agents persuading them to sell. In the cross-examination on Mr B by Ms Chan the Board learnt that the agents could find a buyer within two days after the Taxpayers indicated their desire to sell.

### **The Revenue's Arguments**

16. The Revenue attacked the Taxpayers' case by emphasizing the following facts as features consistent with those of trading:

- (a) The short period that the Subject Property was held (that is, the period between purchase and sale).
- (b) The Taxpayers did not take up the assignment before sale.
- (c) The Taxpayers did not move in and live there before sale.
- (d) A significant profit was made within a short period of time.
- (e) The price was beyond the Taxpayers' financial ability to pay.

17. The Board has made its finding on the last item in earlier paragraphs. As to the other points, the Board has to analyse the evidence further and to consider whether it will come to the same conclusion as the Commissioner has done.

### **Taxpayers' Evidence**

18. In the Agreed Facts and from the cross-examination on Mr B by Ms Chan, the Board finds the following as facts:

- (a) After the sale of the Subject Property the Taxpayers with their family moved to and still live at a flat in the estate of the Subject Property;
- (b) On 20 July 1993, about four months after acquisition of the Subject Property, they arranged for their children to study nearby;

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- (c) They could easily dispose of the Subject Property at a price of \$4,300,000, out of which a profit of about \$1,667,000 was made within a short period of ten months.

19. The above facts indicate that their desire to live in the estate of the Subject Property was very firm; otherwise they would not have arranged for their children to study nearby and moved there even after they had sold their unit.

20. Since they were unable to find any mortgage loan, the only possible way was to sell the Subject Property, particularly, when the price offered was so high that the profit made was almost equivalent to Taxpayers' seven years income. The temptation to sell at that time was great and their decision to sell is understandable.

### **Decision**

21. Having considered all the evidence before the Board, its members unanimously find that the Taxpayers' intention to acquire the Subject Property was for their own use and that the Taxpayers have discharged their burden of proof. For the above reasons the Board overturns the Commissioner's determination of 18 March 1996 and direct that the profits arising out of the purchase and sale of the Subject Property should not be subject to profits tax. Appeal is allowed.