

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D6/98

Profits tax – real property – intention to trade – onus of proof – whether the profits arising from the dispositions of three flats were liable for profits tax – sections 2 and 68(4) of the Inland Revenue Ordinance.

Panel: Ronny Wong Fook Hum SC (chairman), Ng Yin Nam and David Wong Pui Hon.

Date of hearing: 11 November 1997.

Date of decision: 3 April 1998.

The taxpayer was a handicapped person suffering from the effect of polio. She was single and worked as an account clerk with earnings approximately \$6,500 to \$7,000 per month. She claimed that by virtue of her personal circumstances, she had to make provision for her own future and her goal was to have a flat for her own use and a flat to generate rent for her upkeep.

In September 1987, the taxpayer purchased Flat A for \$245,000 and sold it for \$433,000 in October 1990. In February 1991 she bought Flat B in which she lived for two years and then she rented it out. She was still the owner at the time of this appeal.

On 10 August 1991 the taxpayer entered into a provisional agreement for the purchase of Flat D in Garden F, the first of three flats which is the subject matter of this appeal. She paid a deposit and the balance of the purchase price was payable on delivery of vacant possession scheduled on 28 September 1991. Flat D was located near a school and was found to be peaceful and quiet when the taxpayer inspected it. The taxpayer claimed she spent \$128,430 in decorating the flat. On start of the school term the taxpayer found the flat noisy and sold it on 9 September 1991.

The real estate agent who handled the taxpayer's sale and purchase of Flat D put her onto Flat E, also in Garden F. On 26 September 1991 she entered into the purchase agreement for \$1,043,000. She claimed that later she discovered that vacant possession could only be obtained on 15 January 1992. She needed a new flat urgently as her relationship with her family was strained. Furthermore, she ascertained from her banker that mortgage facilities would not be available due to credit squeeze. She was left with no choice but to sell Flat E. It was sold on 9 January 1992 for \$1,250,000.

On 15 October 1991, the taxpayer entered into a provisional agreement for the purchase of Flat G and the signing of the formal sale and purchase agreement was scheduled on 7 November 1991. The taxpayer claimed that the vendors of the flat were her personal friends. After the sale, the vendors would like their son to retain the premises and urged the taxpayer to accede to their wish. The taxpayer complied with their request and on 28

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October 1991 she entered into a provisional agreement for the sale of the flat. She charged an additional \$50,000 over and above her purchase price in order to cover her expenses. After defraying commission and legal fees, she had approximately \$20,000 left.

Held:

- (1) The sale of Flat A in October 1990 had left the taxpayer a sizeable sum after discharge of the mortgage. Coupled with her salary, she would just about meet the target that she set for her own future.
- (2) In relation to Flat D, it would not be realistic to regard the renovations as steps that she took to improve the flat with the view of disposition. Her purchase did coincide with the school holidays.
- (3) The taxpayer's evidence that the same agent recommended Flat E to her when they realised her dissatisfaction with Flat D was accepted. So was her explanation that there was urgency arising from her domestic problem.
- (4) The taxpayer's evidence that she disposed of Flat G in order to accommodate her friends was also accepted. The \$50,000 was not intended to be her profit but was to cover her exposures arising from the purchase and sale.

Appeal allowed.

Cases referred to:

Simmons v IRC [1980] 1 WLR 1196
All Best Wishes Limited v CIR 3 HKTC 750

Tam Tai Pang for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The Facts

1. The Taxpayer is a handicapped person suffering from the effect of polio. She is still single. In the tax years in question, she worked as an account clerk with a building materials company earnings approximately \$6,500 - \$7,000 per month.
2. The Taxpayer dealt in properties. On 3 September 1987, she purchased Flat A for \$245,000. Flat A was mortgaged in favour of a bank to secure facilities in the sum of \$190,000. It was eventually sold on 13 October 1990 for \$433,000.

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3. Her next purchase occurred on 21 February 1991. She sought Flat B for \$775,000. She mortgaged this flat in favour of Bank C for \$350,000. She lived in Flat B for two years and then rented it out. She is still the current owner of Flat B although the same is now subject to a charging order in favour of the Commissioner dated 25 August 1997.

4. About six months later, she entered into a provisional agreement dated 10 August 1991 for the purchase for the first of three flats which is the subject matter of this appeal. The first one was Flat D of Gardens F. She paid \$40,000 by way of deposit. The balance of the purchase price was payable on delivery of vacant possession scheduled on 28 September 1991. She allegedly spent \$128,430 in decorating this flat. It was however sold by her on 9 September 1991 for \$1,243,000.

5. Slightly over a month later, the Taxpayer purchased on 26 September 1991 another flat in Gardens F – Flat E for \$1,043,000. She paid \$30,000 as initial deposit upon the signing of the provisional agreement. The provisional agreement further provided for the signing of a formal agreement on 28 September 1991, for payment of decoration fees of \$36,350 upon the signing of such formal agreement and for payment of the balance of the purchase price on 15 January 1992. Flat E was however sold by the Taxpayer on 9 January 1992 for \$1,250,000.

6. On 15 October 1991, the Taxpayer entered into a provisional agreement for the purchase of Flat G for \$1,320,000. The provisional agreement called for payment of an initial deposit of \$132,000 and for the signing of a formal agreement for sale and purchase on 7 November 1991. Flat G was then registered in the names of Madam H and Mr I. On 28 October 1991, the Taxpayer entered into a further provisional agreement for the sale of Flat G to a Mr J for \$1,370,000.

7. The issue before us is whether the Taxpayer is liable for profits tax in respect of the profits arising from her dispositions of Flats D, E and G.

Evidence from the Taxpayer

8. She purchased each of Flat D, E and G with the intention of using the same as her residence.

9. Flat D is located near a school. She inspected it during the summer school holidays. It was peaceful and quiet. She renovated the flat but found it noisy on start of the school term. She therefore decided to sell Flat D.

10. The real estate agent who handled her sale and purchase of Flat D put her onto Flat E. She discovered after entering into the agreement for purchase of Flat E that vacant possession could only be obtained on 15 January 1992. She needed a new flat urgently as her relationship with her family was strained. Furthermore, she ascertained from her banker that mortgage facilities would not be available due to credit squeeze. She was left with no choice but to sell Flat E.

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11. The vendors in respect of Flat G were her personal friends. After their sale to the Taxpayer, those vendors would like their son to retain the premises and urged the Taxpayer to accede to their wish. The Taxpayer complied with their request and charged an additional \$50,000 over and above her own purchase price in order to cover her expenses. After defraying commission and legal fees, she had approximately \$20,000 left.

12. She emphasised that by virtue of her personal circumstance, she had to make provision for her own future. Her goal was to have a flat for her own use and a flat to generate rent for her upkeep. She now resides in a flat in District K.

The applicable principles

13. Section 2 of the Inland Revenue Ordinance (the IRO) defined 'trade' to include 'every trade and manufacture, and every adventure and concern in the nature of trade.'

14. Trading requires an intention to trade. The question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? (per Lord Wilberforce in Simmons v IRC [1980] 1 WLR 1196 at 1199).

15. The stated intention of the taxpayer cannot be decisive. The actual intention can only be determined upon the whole of the evidence (Per Mortimer J in All Best Wishes Limited v CIR 3 HKTC 750).

16. Section 68(4) of the IRO provides that 'The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'

Our decision

17. We have the benefit of seeing the Taxpayer when she gave evidence before this Board. She is a person with determination. We accept her evidence that at the material time she had a genuine intention to make provision for herself.

18. The Revenue emphasised that the prices for Flats D, E and G were over \$1,000,000 each. On the assumption of a 70% mortgage, the Revenue submitted that the Taxpayer would not be able to support the mortgage instalments for nay one of those flats bearing in mind the Taxpayer's liabilities for Flat B. We think not. The Taxpayer had sold Flat A in October 1990. She would be left with a sizeable sum after discharge of the mortgage. Coupled with her salary, we are of the view that the Taxpayer would just about meet the target that she set for her own future.

19. In relation to Flat D, there was no challenge from the Revenue that the Taxpayer did incur \$128,430 on renovations. It would not be realistic to regard these renovations as steps that she took to improve Flat D with the view of disposition. Her purchase did coincide with the school holidays. This lends credibility to her case. We

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accept the Taxpayer's contention that Flat D was purchased with the intention of using the same as her residence.

20. Given our finding in paragraph 19 above, we are of the view that little distinction can be drawn between Flat D and Flat E. Both Flats D and E were handled by the same estate agent. We accept the Taxpayer's evidence that the same agent recommended Flat E to her when they realised the Taxpayer's dissatisfaction with Flat D. Whilst the provisional agreement for the purchase of Flat E stipulated 15 January 1992 as the date for payment of the balance of the purchase price, the space for delivery of vacant possession was left blank. There is therefore room for misunderstanding as to when the Taxpayer would obtain delivery of vacant possession. We accept the Taxpayer's explanation that there was urgency arising from her domestic problems. This led to the prompt disposal of Flat E.

21. Flat G was purchased on 15 October 1991. This was after the formal sale and purchase agreement in respect of Flat E. The Taxpayer would have realised by then that she could not get early possession of Flat E. The 15 October 1991 provisional agreement in respect of Flat G called for completion on 23 November 1991. This adds weight to the Taxpayer's case that she needed space on an urgent basis. The Commissioner made no challenge of the fact that the purchaser from the Taxpayer was related to the vendors selling to the Taxpayer. We accept the Taxpayer's evidence that she disposed of Flat G on 28 October 1991 in order to accommodate her friends. The \$50,000 was not intended to be her profit. That sum was to cover her exposures arising from the purchase and sale.

22. For these reasons, we allow the Taxpayer's appeal.