Case No. D8/90

Profits tax – purchase and sale of flat – whether trading profit – burden of proof.

Panel: William Turnbull (chairman), John Haggarty and Benjamin Kwok Chi Bun.

Dates of hearing: 14 and 17 February 1990.
Date of decision: 24 April 1990.

The taxpayer acquired a flat in association with his brother-in-law. He sold the flat at a profit and was assessed to profits tax. He appealed to the Board of Review and submitted that he and his brother-in-law had purchased the flat for accommodating their children whilst they were working.

Held:

The taxpayer had not satisfied the Board that when he purchased the flat with his brother-in-law it was not a venture in the nature of trade.

Appeal dismissed.

S P Barns for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

This is an appeal by one of two taxpayers against an assessment to profits tax on a profit which arose from the sale of a flat. The facts are as follows:

1. The Taxpayer who brought this appeal ('the Taxpayer') was a school teacher living in a flat owned by himself and his wife at A Place ('flat A') on Hong Kong Island. The brother-in-law of the Taxpayer was an employee of X Company who lived in a flat which he owned in B Place which is not very far away from A Place.

2. X Company developed a property at C Court at B Place and offered preferential terms and priority to members of its staff to buy flats therein.

3. The Taxpayer and his brother-in-law agreed with each other that they would apply for one of the flats at X Company development. The application was accepted and the Taxpayer and his brother-in-law were allocated a flat on preferential price terms by X Company ('flat C').

4. The Taxpayer and his brother-in-law paid the initial deposit for flat C on 13 July 1985. The Taxpayer anticipated that the occupation permit would be issued in the middle of the following year and the occupation permit was in fact issued in October 1986.

5. On 8 August 1986, the Taxpayer and his brother-in-law entered into an agreement for the sale of flat C at a price which was substantially higher than the price which they had agreed to pay for it. After the occupation permit had been issued, the Taxpayer and his brother-in-law on 18 October 1986 completed the sale as confirmors of flat C and realised a profit of $107,472 which was divided equally between them.

6. On 1 October 1986, the Taxpayer entered into a sale and purchase agreement for a flat at D Place ('flat D'). The occupation permit for this flat was issued on 21 June 1988 and the Taxpayer completed the purchase of flat D in August 1988. After decorating flat D, in November 1988, the Taxpayer moved into the same which became his home and he subsequently sold flat A.

7. The assessor of the Inland Revenue Department was of the opinion that the purchase and subsequent sale by the Taxpayer and his brother-in-law of flat C was a venture in the nature of trade and that the profit made by them of $107,472 was taxable. He accordingly assessed them to tax. The Taxpayer and his brother-in-law filed notice of objection to this assessment and the matter was determined by the Deputy Commissioner who in his determination dated 20 October 1989 upheld the assessment issued by the assessor.

8. On 18 November 1989, the Taxpayer gave notice of appeal to the Board of Review against the determination of the Deputy Commissioner but the Taxpayer's brother-in-law did not appeal and accepted the assessment so far as he was concerned.

At the hearing of the appeal, the Taxpayer appeared on his own behalf and gave evidence. In addition, the Board of Review had before it a number of letters written by the Taxpayer and the Taxpayer's brother-in-law to the Inland Revenue Department and to the Board of Review. The Taxpayer did not call his brother-in-law to give evidence and likewise did not call his own wife or his brother-in-law's wife to give evidence.

The written submissions of the Taxpayer and his brother-in-law to the Inland Revenue Department, the grounds of appeal of the Taxpayer, and the evidence given by the

Taxpayer and the submissions made by the Taxpayer had a number of inconsistencies in them.

The original case for the Taxpayer would appear to have been that the Taxpayer and his brother-in-law were concerned about the upbringing and welfare of their respective children. The reason given for the purchase of flat C was that it would be used collectively by them for the purpose of accommodating their children during the daytime when the Taxpayer was at work as a teacher. The brother-in-law was required to work a shift system with X Company and it was not convenient for him to have the children of himself and the Taxpayer in his own flat in B Place when he was at home during the day trying to rest or sleep. It was suggested that for this reason, the Taxpayer and his brother-in-law decided to take the opportunity of acquiring a flat on beneficial terms through the employment of the brother-in-law with X Company.

Little if any evidence was given before the Board in support of this proposition. Instead the Taxpayer concentrated his efforts in his submissions and in his evidence on a statement that he wished to move from flat A because it was hot and noisy. He said that it faced north-west which made it hot and that in an adjoining flat, there was a music teacher who gave piano lessons and caused disturbance. Because of this and because flat D faced south-east and was in a better environment, he decided to move to flat D when it became available.

The Taxpayer stated that he did not move into flat C because of noise from aeroplanes and the nearby traffic but no evidence was given to corroborate this statement by the Taxpayer and the Taxpayer did not indicate when he became aware of this alleged noise factor.

On the verbal evidence of the Taxpayer and the documentary evidence before us we do not accept the submission that the Taxpayer and his brother-in-law at any time had the intention of using flat C for the purpose of collectively looking after their children during the daytime. There is little or no evidence to support this proposition. It would be a most unusual arrangement for two families to maintain their own places of full-time residence, one at A Place and the other at B Place, and in addition to have a third flat dedicated for the purpose of looking after their children. Having rejected this part of the Taxpayer's case, it is necessary to look at the rest of the facts to see whether or not this was a venture in the nature of trade by the Taxpayer and his brother-in-law or whether it was the acquisition of a capital asset which they subsequently sold and realised a capital profit.

We accept the evidence of the Taxpayer when he said that he decided to move from flat A to flat D because the environment of flat D was better than flat A. We accept that flat A was noisy and hot and, that this was the reason why the Taxpayer decided to acquire and move into flat D. However, this does not assist him in relation to the flat which is the subject matter of this appeal, namely, flat C.

The main thrust of the Taxpayer's submission to us was that in his opinion, he should not pay tax on the profit which he realised on the sale of flat C because he used the proceeds from the sale of flat C to reinvest in flat D and therefore did not realise any profit. With due respect to the Taxpayer, this submission has no substance in it whatsoever. A trading transaction does not become a capital gain because one decides to reinvest the proceeds in residential accommodation for oneself. If it was the intention of the Taxpayer when he acquired flat C to use it as his residence in place of flat A and subsequently for good and valid reasons decided to change his mind and sell flat C and either continue to live in flat A or move to a different flat, in this case flat D, then the gain would be a capital gain and not taxable. Though this was not the submission expressly made by the Taxpayer on his behalf, it is the submission which is implicit in his appeal and accordingly is the basis on which we will consider the appeal as it is the most favourable for the Taxpayer. To avoid any possible doubt, this point was put to the representative for the Commissioner in the course of the hearing as being the essence of the Taxpayer's case. It is appreciated by the Board that in cases of this nature where a taxpayer has no professional representation and has a limited knowledge of the law of taxation, the Board should assist in the legal formulation of the case which the Taxpayer has submitted.

Unfortunately for the Taxpayer, even on this most favourable aspect of his submission, the facts as we find them do not substantiate that the Taxpayer had the intention of living with his family in flat C.

The original submission, which we have found not to be true, was that the Taxpayer and his brother-in-law intended jointly to use flat C for their children. We furthermore have the situation that the brother-in-law has chosen not to participate in this appeal and has accepted the determination of the Commissioner. This must indicate that so far as the brother-in-law is concerned, he accepts that the purchase and sale of flat C was a venture in the nature of trade and that his half share of the profit is taxable. The onus of proof is on the Taxpayer and in the light of the fact that his brother-in-law has not participated in this appeal, it makes the burden of proof on the Taxpayer a heavy one to substantiate his case.

The acquisition of flat C could only be for one of a limited number of reasons. It could have been as a future residence for either the Taxpayer or his brother-in-law but, on the facts of this case, not collectively for both. It could have been as a long term investment with a view to collecting rent which would be divided between the Taxpayer and his brother-in-law, but on the facts of this case, there is no such suggestion. It could have been for some collective reason, such as a daytime accommodation for their children, but we have rejected this submission as a matter of fact. It could have been that the Taxpayer and his brother-in-law decided to purchase flat C with a view to reselling it at a profit. Of these various possibilities, only the first, namely that the Taxpayer intended the flat to be his future residence, or the last, namely that the Taxpayer and his brother-in-law acquired the flat with a view to selling it at a profit is of concern to us in this appeal.

On the facts before us, we find that the Taxpayer has not been able to satisfy the burden of proof placed upon him to demonstrate that he did not intend to acquire and sell flat C at a profit.

Whilst we accept that his reason for selling flat A and acquiring flat D was with a view to moving his residence from one to the other, we have no such evidence with regard to flat C. He told us the reason for not retaining flat C, so far as he was concerned, was that the environment of flat C was not to his liking because of noise from aeroplanes and the nearby traffic. However, the noise factor, if it existed, existed at the time when he decided to acquire the flat with his brother-in-law. The Taxpayer never moved into flat C and indeed sold it before construction was completed. Whatever information he had available when he sold the flat would have been available to him when he purchased it. It is also interesting to note that flat D is if anything closer to the flight path to the airport than flat C being nearer to the airport and in approximately the same line as flat C.

There is no evidence before us of any agreement between the Taxpayer and his brother-in-law that flat C was purchased by them jointly, so that the Taxpayer could live in flat C on his own. Apparently they paid equally for flat C. If it was to be the sole residence of the Taxpayer, one would have expected all the money to have been paid by the Taxpayer himself. That was not the case. There is no explanation as to why the brother-in-law would use his own money to subsidise the Taxpayer. It may be that the purchase agreement had to be in the joint names of the Taxpayer and his brother-in-law to take advantage of the employee benefit scheme of X Company, but that would not explain why privately between themselves the Taxpayer and the brother-in-law jointly put up the moneys required in equal shares.

The facts before us which we accept are simple. The Taxpayer and his brother-in-law decided to jointly purchase a flat at C Place in their joint names taking advantage of X Company employee benefit scheme. Shortly before the occupation permit was issued, they sold flat C and realised a substantial profit. We do not accept any of the evidence given to us by the Taxpayer that it was ever his intention to retain flat C either himself alone or jointly with his brother-in-law. On those simple facts, we find that it was the intention of the Taxpayer and his brother-in-law to purchase flat C as a venture in the nature of trade with a view to selling the flat at a profit which they did.

For the reasons given, we dismiss this appeal and confirm the determination of the Deputy Commissioner.