

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D8/95

Profits tax – purchase and sale of residential apartment – whether profit assessable to profits tax.

Panel: Ronny Wong Fook Hum QC (chairman), Terence Tai Chun To and Alexander Chung Ho Woo.

Date of hearing: 7 April 1995.

Date of decision: 8 May 1995

A husband and wife purchased a residential apartment and shortly thereafter sold the same at a profit as confirmor. The assessor assessed the resulting profit to profits tax. The taxpayers appealed to the Board of Review on the ground that it was a capital gain and gave evidence before the Board. The Board accepted the evidence of the taxpayers. The Board accepted there had been a change of intention by the taxpayer.

Held:

The taxpayers had fully discharged the onus imposed upon them. Assessment annulled.

Appeal allowed.

Case referred to:

Lionel Simmons Properties Ltd v CIR 53 TC 461

Ng Kwok Yin for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

I. THE BACKGROUND

1. The Taxpayers are husband and wife. Mr A was and still is a taxi-driver. Mrs A worked as clerk with Bank X until her retirement on 12 December 1989. Bank X paid her \$175,956 on her retirement.

2. In 1980, they purchased Flat P for \$370,000. They lived there for 6 years. This flat was sold on 18 December 1986 for \$520,000. The couple then moved to Flat Q in a

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private housing estate (Estate Y) which they purchased with the aid of a mortgage. Monthly repayment under this mortgage was \$3,000. The couple had since been and still are residing in Flat Q of Estate Y.

3. On 23 March 1991, Mrs A entered into a provisional agreement for the purchase of Flat R ('the Suit Premises') for \$1,381,000. Formal agreement for purchase was executed in April 1991 in the joint names of the couple. They paid 10% of the purchase price. The balance of \$1,242,900 was raised by an equitable mortgage repayable by 240 instalments of \$11,994.3 per month.

4. On 31 July 1991, Mr & Mrs A sold the Suit Premises as confirmor for \$1,555,000. The Revenue contends that this disposition gave rise to assessable profits in the sum of \$95,185 with tax thereon at \$14,277.

5. On 7 February 1992, Mrs A and her daughter jointly acquired Flat S in Estate Y. This was let out to a tenant shortly after the purchase. Until the recent increase of interest rate, rental from this Flat S in Estate Y was sufficient to cover monthly mortgage instalment payment of \$12,000. Despite the sharp increase in the value of this Flat S in Estate Y, Mrs A had never attempted to dispose of the same.

6. The couple has a daughter and 3 sons. Their eldest child (a daughter) was married in 1990. She was 24 years of age in 1991. The eldest son was 23 in 1991. He was on the verge of marriage but his plans were frustrated by virtue of disagreements with his girl friend. He is still unmarried and resides with the couple at Flat Q. The other 2 sons were respectively 21 & 19 in 1991. They too are living with the couple at Flat Q.

7. Apart from the transactions outlined above, the couple had not been involved in any other property transactions.

II. THE ISSUE & THE RELEVANT LEGAL PRINCIPLES

1. The issue is whether the profits arising from the couple's disposal of the Suit Premises amounting to \$95,185 should be assessable to profits tax.

2. We are grateful to Mr Ng of the Revenue in summarising for our benefits the applicable principles.

3. Section 14 of the Inland Revenue Ordinance ('the IRO') provides that:

'Subject to the provision of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part ...'

4. Section 2 of the IRO provides that:

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

5. As pointed out in Lionel Simmons Properties Ltd v CIR 53 TC 461 at page 491:

'... Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of acquisition of the asset. Was it acquired with an intention of disposing it at a profit, or was it acquired as a permanent investment?'

6. We have been reminded by the Revenue that the subjective intention of a person has to be measured by the objective circumstances and that section 68(4) of the IRO imposes on the couple the onus of proving that the assessment is excessive or incorrect.

III. THE CONTENTIONS OF THE PARTIES

1. Both Mr & Mrs A gave evidence. We are impressed by their demeanour. We accept their testimony.

2. According to Mr & Mrs A:

- (a) They were anxious to make provisions for their children. Their means were limited but they would like to try their best. There was then real prospect of their eldest son getting married.
- (b) It was fortuitous for them to acquire the Suit Premises. They were told by the sales office that the same was the last available flat within that particular complex.
- (c) After the purchase, through discussions with friends and relatives, they re-assessed the desirability of their acquisition. The possibility of leakage from the roof and the distance between the Suit Premises and Flat Q prompted them to dispose of the Suit Premises.
- (d) Flat S was purchased as a replacement serving the same purpose. It is in close proximity with Flat Q in the same estate. The daughter joined in the purchase so as to ease the burden. This Flat S has been retained to-date despite sharp rise in price.
- (e) The sons and the couple are still sharing Flat Q. The sons are still single and there is no urgent need to utilise Flat S.

3. The Revenue has placed reliance on the following:

- (a) The alleged intention of the couple to use the roof-top of the Suit Premises as their children's residence is open to doubt by virtue of the well known illegality of such usage;

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- (b) The financial position of the couple in 1991: their earnings as reported to the Revenue casts doubt on their ability to finance the purchase of the Suit Premises on a long-term basis;
- (c) The short period of ownership; and
- (d) The reasons put forward by the couple for sale of the Suit Premises are not compelling.

IV. OUR FINDING AND DECISION

1. The couple impressed us as caring parents of 4 children who genuinely wished to make provisions for their children's accommodation.
2. Three factors weighed heavily in our deliberation:
 - (a) Apart from the transactions outlined in section I above, the couple had never engaged in any speculative dealing in real property;
 - (b) The Suit Premises was replaced by Flat S. This is situated within the same complex as their current residence and adds weight to their explanation leading to the disposal of the Suit Premises and
 - (c) The wife has retained her interest in Flat S despite sharp increase in price.
3. Whilst we recognise the force of some of the points urged upon us by the Revenue, we are of the view that the Taxpayers have fully discharged the onus imposed on them. We would discharge the assessment and order accordingly.