

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D8/98

Profits tax – real property – intention of taxpayer at the time of purchase – ‘genuinely held, realistic and realisable’ – whether the profits arising from the disposition of a property was liable for profits tax.

Panel: Ronny Wong Fook Hum SC (chairman), Alfred Chow Cheuk Yu and Ronald Tong Wui Tung.

Date of hearing: 13 December 1997.

Date of decision: 3 April 1998.

In January 1987 the taxpayer bought Flat A and his family resided therein since the purchase. In October 1990, he bought Flat C which is the subject of this appeal. Flat C was then under construction. In February 1992, the taxpayer entered into a provisional agreement to sell Flat C. The sale was completed in July 1992 with the taxpayer acting as confirmor.

The taxpayer claimed his original intention was to use Flat C as the residence of his family. He sold Flat C because his mother opposed to the intended move. He also informed the Inland Revenue Department that Flat C was sold in order to raise fund to support the purchase of a shop which he and his wife jointly purchased in March 1992. The purchase was completed in July 1992.

The taxpayer laid considerable emphasis on the fact that Flat C was purchased shortly after Iraq's invasion of Kuwait on 2 August 1990. The property market in Hong Kong was on the low. No one would venture into the market unless prompted by genuine needs.

The taxpayer furnished to the Inland Revenue Department information in relation to the residence of his own and that of his close relatives. He also admitted the dealings of 12 properties either by himself or his close family members.

Held:

(1) The purchase of Flat C has to be considered in the context of the pattern of property dealings of the taxpayer. The taxpayer had conducted no less than 6 property deals between 1985 and 1990. The Revenue however did not challenge the fact that no profit was made on sale of 4 flats. It is therefore difficult to infer from the taxpayer's prior dealings that his purchase of Flat C was prompted by a profit motive derived from his past property deals.

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(2) The evidence pertaining to the residence of the Taxpayer and his close family members lends credence to his case.

(3) What finally tilts the balance in favour of the taxpayer is the timing of his purchase. The taxpayer's evidence that with the onset of the Gulf War it is unlikely for a person with his background to venture into the property market for speculative gains is accepted.

Appeal allowed.

Case referred to:

All Best Wishes v CIR 3 HKTC 750

Chiu Kwok Kit for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The Background

1. On 22 January 1987, the Taxpayer purchased Flat A of Garden B for \$662,318. This property has a gross floor area of 855 square feet. The Taxpayer has been residing in this property since his purchase.

2. By a provisional agreement dated 30 October 1990, the Taxpayer purchased Flat C of Garden D for \$1,292,000. Flat C was then under construction. It is of a gross floor area of 785 square feet.

3. By a provisional agreement also dated 30 October 1990, the Taxpayer's wife ('the Wife') and his sister-in-law ('the Sister-in-law') purchased Flat E of Garden D for \$1,491,700. The consideration for this flat was subsequently reduced to \$1,297,100. It is of the same size as Flat C.

4. On 6 November 1990, the Taxpayer took out a bank loan of \$1,163,520 to finance his purchase of Flat C. This loan was repayable by 240 monthly instalments of \$11,616 each. One day later, the Wife and the Sister-in-law took out a bank loan of \$1,167,390 to support their purchase of Flat E. Their bank loan was repayable by 240 monthly instalments of \$11,655 each.

5. The occupation permit in respect of the development at Garden D was granted on 20 December 1991.

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6. By a provisional agreement dated 17 February 1992, the Taxpayer sold Flat C for \$2,650,000. The sale was completed on 9 July 1992 with the Taxpayer acting as confirmor.

7. By an agreement dated 23 March 1992, the Wife and the Sister-in-law sold Flat E for \$2,950,000. The sale was completed on 16 June 1992 with the Wife and the Sister-in-law acting as confirmors.

8. By an agreement dated 27 March 1992, the Taxpayer and the Wife jointly purchased Shop F at District G for \$2,550,000. The purchase was completed on 7 July 1992. The Shop was let out for rental income on 1 January 1993. The Taxpayer informed the Inland Revenue Department on 29 April 1995 that although her purchased Flat C intending to use the same as his residence, it was sold in order to raise fund to support the purchase of Shop F.

9. In his correspondence with the Inland Revenue Department, the Taxpayer advanced the following contentions:

- a. His original intention was to use Flat C as the residence of himself, his wife and his daughter who was born on 21 May 1989. Flat E was to be used by his mother ('the Mother') and his younger sister ('the Sister').
- b. There was no consultation with the Mother prior to his purchase of Flat C.
- c. He financed the purchase of Flat C. His younger brother ('the Brother') and his Sister-in-law financed the purchase of Flat E.
- d. The Mother opposed the move to Flats C and E as they were far away from the residence of the Brother in District G. Flats C and E were sold in the light of the Mother's objection.
- e. The Taxpayer did not make alternative purchase in order to accommodate the Mother and the Sister. They moved into the Brother's flat after the sale of Flats C and E. Furthermore the Taxpayer had to use the proceeds of sale from Flat C to support his purchase of Shop F.

10. The Taxpayer furnished to the Inland Revenue Department the following information in relation to the residence of his own and that of his close relatives:

Date	Taxpayer	Mother and Sister	Brother
22-1-1987	Flat A of 855 square feet	Flat A	-

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8-2-1990	Flat A	Flat A	Flat H of 597 square feet
30-10-1990 (Flat C of 785 square feet purchased)	-	-	-
17-2-1992 (Flat C sold)	-	-	-
15-7-1992	Flat A	Flat A	Flat I of 776 square feet
August 1992	Flat A	Flat I	Flat I
March/April 1993	Flat A	Flat J of 530 square feet	Flat I
August 1994	Flat A	Flat J	Flat H
September 1994	Flat A	Flat H	Flat H
November 1995	Flat A	The Housing Estate Flat of 450 square feet, District K	The Housing Estate Flat
July 1996	Flat A	Flat I	Flat I
Current	Flat A	Flat L, District K	-

11. The issue before us is the taxability or otherwise of the profits arising from the Taxpayer's dealings of Flat C.

Evidence of the Taxpayer

12. He admitted the following property dealings by himself and his close family members.

	The Property	Person dealing with the property	Date of purchase	Purchase price \$	Date of sale	Sale price \$

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1.	Flat M	The Taxpayer	9-3-1985	431,800	15-5-1985	431,800
2.	Flat N	The Taxpayer	25-6-1985	456,200	14-3-1986	456,200
3.	Shop O	The Taxpayer	2-5-1986	320,000	7-4-1997	3,800,000
4.	Flat A	The Taxpayer	10-4-1986	662,318	-	-
5.	Flat P, Garden R	The Taxpayer	31-10-1989	1,128,960	15-9-1990	1,128,960
6.	Flat Q, Garden R	The Wife	31-10-1989	1,131,900	25-9-1990	1,131,900
7.	Flat C	The Taxpayer	30-10-1990	1,292,800	17-2-1992	2,650,000
8.	Flat E	The Wife and the Sister-in-law	2-11-1990	1,297,100	23-3-1992	2,950,000
9.	Shop F	The Taxpayer and the Wife	27-3-1992	2,550,000	-	-
10.	Flat J	The Taxpayer	9-3-1993	1,586,000	8-8-1994	2,340,000
11.	Shop S	The Taxpayer and the Brother	6-4-1995	4,050,000	-	-
12.	Flat L	The Taxpayer	26-6-1996	3,136,000	-	-

13. He was brought up living in the 400 odd square feet housing estate flat. He has 4 brothers and sisters.

14. His father passed away in 1984. The Housing Estate Flat was insufficient for the family. He therefore bought Flat M.

15. He was dissatisfied with Flat M. He therefore moved to Flat N. Flat N was of an area of about 500 square feet with only two rooms. He was getting married and had to look for additional space. Flat N was therefore sold in order to purchase Flat A.

16. His grandmother, the Mother and the Sister moved into Flat A with the Taxpayer and the Wife. His grandmother passed away in 1988. His eldest daughter was born in 1989. Disputes arose between the Wife and the Mother. He therefore looked for two separate units for the Wife and the Mother to live apart.

17. Flats P and Q were purchased with that aim in mind. At the time of purchase, the two flats were in the course of construction. Closer examination after their purchases revealed that their total area was only 1,200 square feet. The amount of additional space

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was therefore limited. Flats P and Q were therefore sold before they were completed. He did not consult the Mother prior to the purchase of Flats P and Q.

18. Flats C and E were then acquired. The Mother however refused to move as the Brother was residing in Flat H. Flats C and E were therefore sold whilst they were still being constructed. He used the proceeds of sale to purchase Shop F.

19. Relationship between the Mother and the Wife deteriorated for the worse. The Mother had to move. Flat J was then purchased for the Mother. The Mother and the Sister moved into this flat. Management of Flat J was poor. The meat shop at the back of the flat was unhygienic. The Mother therefore moved to live with the Brother.

20. The Mother and the Brother lived together for a while and the two expressed the wish to live apart. Flat L was then purchased for Mother. She has been living in that flat ever since.

21. He has been a member of the civil service for over 21 years. His salary in October 1990 was about \$7,000 to \$8,000 per month. At no time did the Wife hold any job of her own. Shop O was let out with rent at about \$10,000 per month. He had to lead a very thrifty life in order to support the mortgage instalments for Flat C.

22. He laid considerable emphasis on the fact that Flat C was purchased shortly after Iraq's invasion of Kuwait on 2 August 1990. The property market in Hong Kong was on the low. No one would venture into that market unless prompted by genuine needs.

23. He still holds Flat A, Shop F, Shop S and Flat L.

The applicable principles

24. The principles are clear. We have to ascertain the intention of the Taxpayer at the time when Flat C was purchased. We have to be satisfied that his intention was to purchase that flat as his residence and that intention is on the evidence 'genuinely held, realistic and realisable'.

25. As pointed out by Mortimer J (as he then was) in All Best Wishes Limited v CIR 3 HKTC 750:

'It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said that action speak louder than words.'

Our decision

26. The purchase of Flat C has to be considered in the context of the pattern of property dealings of the Taxpayer summarised in paragraph 12 above. It is not a one off

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transaction. Between 1985 and 1990, the Taxpayer had conducted no less than 6 property deals. His acquisition and disposal of Flat C bear distinct similarities with his dealings in relation to Flat P. Both were held for relatively short periods of time and disposed of prior to completion of the units. The Revenue however did not challenge the fact that no profit was made on sale of Flat M, Flat N, Flat P and Flat Q. It is therefore difficult to infer from the Taxpayer's prior dealings that his purchase of Flat C was prompted by a profit motive derived from his past property deals.

27. It is the Taxpayer's case that Flat C and Flat E were purchased as part of his plan to segregate the Wife and the Mother. He was then earning about \$6,000 to \$7,000 per month. The rent from his Shop O was about \$10,000 per month. He said the Brother and the Sister-in-law would finance the purchase of Flat E. We do not know what their respective occupation and income were. On the evidence before us, instalment payments of about \$11,000 each in respect of both Flats C and E were met between November 1990 and February/March 1992. The Taxpayer's evidence that he tried hard to support the purchase of Flat C is therefore not without substance.

28. We have also reviewed the Taxpayer's case in the light of the evidence pertaining to the residence of himself and his close family members summarised in paragraph 10 above. The evidence suggests a very close affinity between the Mother and the Brother. The Brother started to live in Flat H in February 1990. That was of 597 square feet. The Brother moved into Flat I of 776 square feet in July 1992. The Mother followed thereafter in August 1990. This lends credence to the Taxpayer's case that the relationship between the Mother and the Wife was a strained one. It also demonstrates the genuineness of the Mother's objection to move to Flat C.

29. What finally tilts the balance in favour of the Taxpayer is the timing of his purchase. We accept his evidence that with the onset of the Gulf War it is unlikely for a person with his background to venture into the property market for speculative gains.

30. For these reasons, we allow the Taxpayer's appeal and discharge the assessment on him.