

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D93/00

Profits tax – real property – whether the gains arising from the disposal of properties were liable for profits tax.

Panel: Ronny Wong Fook Hum SC (chairman), Henry Lau King Chiu and Ng Ching Wo.

Date of hearing: 7 July 2000.

Date of decision: 21 November 2000.

The taxpayers were husband and wife. They purchased Property 2 on 28 October 1995. The certificate of compliance was issued on 8 May 1996 and the taxpayers sold Property 2 on 18 June 1996 at a gain.

The taxpayer purchased Property 3 on 23 July 1996. However, the taxpayers rented Property 4 for two years from 1 August 1996 and it was a term of the tenancy that two years rental was payable in any event. On 31 December 1996, the taxpayers sold Property 3 at a gain.

The taxpayers contended, inter alia, that

1. Property 2 was purchased for the convenience of the husband to make daily trips via Lowu for business in China.
2. Property 3 was purchased to cater for the education of the taxpayers' son.
3. The taxpayers spent \$150,000 re-decorating Property 3. Severe leakages from the roof of Property 3 were found and the taxpayers were advised by professionals that remedial works would involve substantial time and expenses.
4. The taxpayers only held one property at a time.

Held:

1. The fact that the taxpayers held one property at a time is, by itself, ambiguous. A trader might hold only one flat as that was all he could afford to have as his stock. In the absence of any substantial use of the relevant flats, the taxpayers can derive little assistance from this pointer.

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2. The Board was not convinced by the taxpayers' evidence that Property 2 was purchased with the genuine intention of using the same as their family home. The Board did not believe that the interests of their young child had escaped their attention until after they obtained possession of Property 2.
3. Had the taxpayers intended to use Property 3 as residence, it was difficult to see why the taxpayers should enter into a tenancy agreement in respect of Property 4 on 23 July 1996 for a period of two years and why they should assume an obligation to pay rent in any event for the full term.
4. The taxpayers did not produce any cheque or receipt evidencing the incurrance of the \$150,000 they said they had spent renovating Property 3 prior to its sale. The taxpayers failed to discharge their onus of proof in displacing the inference of trade arising from the limited duration of their ownership of the flat.

Appeal dismissed.

Case referred to:

All Best Wishes Limited v CIR 3 HKTC 750

Chan Siu Ying for the Commissioner of Inland Revenue.

Amy W S Yung of Messrs Amy Yung & Co for the taxpayer.

Decision:

Background

1. The Taxpayers [hereinafter referred to as 'Mr A' and 'Mrs A' respectively and 'the Taxpayers' collectively] are husband and wife. They have a son born on 1 March 1988.
2. Commencing from September 1994, their son attended a school in District B. The family was then residing in a flat in District C ['Property 1'].
3. By a memorandum for sale dated 28 October 1995, Mr A purchased a flat in District D ['Property 2'] for \$3,780,800. Both Mr and Mrs A were designated as the purchasers in the formal agreement for sale and purchase dated 2 November 1995. The purchase was financed by a loan of \$2,646,560 extended by the Bank E secured by Property 2.

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4. The occupation permit and the certificate of compliance in respect of Property 2 were granted on 3 April 1996 and 8 May 1996 respectively. By a provisional agreement dated 18 June 1996, the Taxpayers sold Property 2 for \$5,000,000.
5. Mr A started working as a real estate agent with Company F on 1 May 1996. He moved to Company G as property consultant on 15 August 1996. According to his returns for the years of assessment 1996/97 and 1997/98, his earnings for those two years were \$217,059 and \$588,260.
6. By a provisional agreement dated 19 July 1996, the Taxpayers purchased a flat (including roof thereof) in District H [' Property 3'] for \$4,150,000.
7. By a tenancy agreement dated 23 July 1996, Mrs A rented a flat in District I [' Property 4'] for two years from 1 August 1996 at a monthly rental of \$18,000. It was a term of this tenancy that two years rental was payable in any event.
8. The purchase of Property 3 was completed on 5 September 1996 with the assistance of a mortgage loan of \$2,900,000 extended by Bank G repayable by 180 monthly instalments of \$30,721.52 each. Shortly thereafter the Taxpayers were called upon by the Incorporated Owners of the housing estate of Property 3 to contribute \$57,600 towards repair of that building. The Taxpayers paid the same on 20 November 1996.
9. By a provisional agreement dated 31 December 1996, the Taxpayers sold Property 3 for \$5,600,000.
10. The issue before us is whether the Taxpayers are chargeable to profits tax in respect of their gains from their dealings with Property 2 and Property 3.

Case of the Taxpayers

11. In relation to Property 2:
 - (a) This flat was allegedly purchased for the convenience of Mr A. Mr A asserted that he had to make daily trips via Lowu for business in China. They selected this flat in District D so as to reduce his travelling time.
 - (b) They obtained possession of this flat in May 1996. They moved into this flat in June 1996 and stayed there for seven to ten days. They did not spend any money re-decorating this flat as it was well furnished by the developer.
 - (c) Their son was then studying in a school in District B. It took their son 45 minutes

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to travel to his school. Attempts to find other schools in District D failed. They therefore had to look for other premises in town to cater for their son's education.

12. In relation to Property 3
- (a) This flat was purchased for the convenience of their son.
 - (b) They discovered after obtaining possession of this flat that its water supply had been cut off six months ago and re-connection of such supply would take a period of two months.
 - (c) They spent \$150,000 re-decorating this flat. Such work was carried out by decorators introduced by their friend in 1985. The renovations took place between September and December 1996. The sum of \$150,000 was paid by instalments. The decorators did not furnish any written quotation.
 - (d) Severe leakages from the roof were found. They took advice from professionals. They were told that remedial works would involve substantial time and expenses. They therefore decided to sell Property 3.

The hearing before us

13. Mr and Mrs A gave evidence before us.

14. According to Mrs A:

- (a) Mr A was in textile business in 1995. He had to pay regular visits to his clients in China. He used extensively the ferry services to and from the Hong Kong and Macau Ferry Pier as his clients were located in City K. It would be more convenient for Mr A to travel via Lowu.
- (b) No substantial re-decoration was done to Property 2. She cannot recall when they moved into that flat. They only took rudimentary furniture into that flat. They wanted to try out life in the countryside. They decided that the flat was unsuitable for their needs after staying there for three to four days.
- (c) She inspected Property 3 several times before their purchase. The location was ideal for her work (she was then working in a district near District H) and her son's education. The conditions of that flat were unsatisfactory. Substantial renovations had to be done to that flat. It was for that reason that the flat was offered to them at a low price. She did not realise that the roof was in such

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dilapidated conditions.

- (d) She realised that renovations had to be done to Property 3. She made some provision (‘several ten thousand dollars’) for such renovation. The extent of the water leakage was totally unexpected. The cost of the proposed remedial work to remove the risk of electric shock was well above her budget. It was in these circumstances that they decided to sell Property 3.
- (e) She inspected Property 4 once or twice prior to renting the same on 23 July 1996. She cannot recall whether those visits were days or weeks before the tenancy.
- (f) She placed considerable emphasis on the fact that they only held one property at a time.

15. Mr A told us that:

- (a) He was a freelance cloth merchant in 1995. Whilst living in Property 1, he had to collect samples from his suppliers and he would then take the ferries in the Hong Kong and Macau Ferry Pier to City K.
- (b) He selected Property 2 because he could then board the train in District D as opposed to District C. The train to Lowu would then be less crowded and he would have more room for his cloth.
- (c) He only spent limited time with Company F in 1996. He was not familiar with the business of real estate agency.
- (d) The family moved out of Property 1 in about March 1996. His family then spent some time living with his mother and his mother-in-law.
- (e) He stayed in Property 2 for about a week. Only bare essentials were moved into that flat. He left the rest of his belongings with his mother and his mother-in-law.

The applicable principles

16. We have to ascertain the intention of Mr and Mrs A at the time when they purchased Property 2 and Property 3. We have to be satisfied that their intention was to purchase each of the premises as their residence and such intention is on the evidence ‘genuinely held, realistic and realisable’.

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17. 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 actions speak louder than words. ’

Our decision

18. We do not place much weight on the fact that the Taxpayers only held one property at a time. That factor, by itself, is ambiguous. A trader might hold only one flat as that was all he could afford to have as his stock. In the absence of any substantial use of the relevant flats, the Taxpayers can derive little assistance from this pointer.

19. We are not convinced by the Taxpayers’ evidence that Property 2 was purchased with the genuine intention of using the same as their family home. The evidence adduced by the Revenue indicates that Mr A regularly travelled to China via the Hong Kong and Macau Ferry Pier. The Taxpayers’ son had been attending a school in District B since 1994. We do not believe that the interests of their young child had escaped their attention until after they obtained possession of Property 2. No decoration was done to that flat. The certificate of compliance was issued on 8 May 1996. They disposed of this property on 18 June 1996. We do not believe that there was any concrete attempt to use this flat as the family’ s residence.

20. We also entertain serious doubt as to the bona fide of the Taxpayers’ case in relation to Property 3. That flat was purchased on 19 July 1996. Had they intended to use the same as their residence, it is difficult to see why they should enter into a tenancy agreement in respect of Property 4 on 23 July 1996 for a period of two years and why they should assume an obligation to pay rent in any event for the full term. The Taxpayers contended that there was no water supply to this flat. This is contradicted by the Revenue’ s evidence that water supply resumed on 19 September 1996, a day after Mr A’ s application for resumption on 18 September 1996. The Taxpayers vaguely suggested that renovations of Property 3 would take time. If 24 months were required to put that flat into a habitable condition, that flat must have been in a very poor state and water leakage must have been within the Taxpayers’ contemplation. The Taxpayers say they spent \$150,000 renovating this flat prior to its sale. The Taxpayers did not produce any cheque or receipt evidencing the incurrance of this sizeable expenditure. We were given no particular as to the nature of the renovation involving this substantial sum. In these circumstances, we are of the view that the Taxpayers failed to discharge their onus of proof in displacing the inference of trade arising from the limited duration of their ownership of this flat.

21. For these reasons, we dismiss the Taxpayers’ appeal.