

# Construction loan: enough to support investment for tax purposes? (2/12/19)

The Administrative Division of the Supreme Court analysed whether the amount an individual borrowed to build a house (in conjunction with other evidence) is a sufficient basis for amounts invested in real estate (RE) and allows a personal income tax (PIT) deduction on the capital gain. This article explores the findings made by the court.

## Background

An individual entered into a contract to sell RE but failed to submit a capital gains tax return in the belief that the sale did not create taxable income. A data compliance review conducted by the State Revenue Service (SRS) resulted in the person being assessed to PIT and a late charge because the person had not filed any supporting documents for purchases of goods and services (such as receipts and workmen's bills).

The person challenged the assessment and took the SRS to court on the following grounds.

The person purchased a piece of land, built a house on it, and sold the RE as a single whole. The person's investment in the RE was based on an amount borrowed to build the house. It is important that the loan was made available to the person in instalments, i.e. each subsequent portion of the loan was issued to the person after receiving a letter from a construction supervisor selected by the bank, confirming that the portion of the loan made available earlier has been used for the stated purpose. So there was evidence that the funds had been used for construction.

## The court ruling

The Supreme Court finds that in this situation the person did not receive income from the RE sale because construction expenses should be taken into account when measuring the amounts invested in the property, considering not only supporting documents (such as receipts) but also the loan made for construction.

The ruling is based on the following findings:

- Three factors come into play when calculating the capital gain subject to PIT:
  1. the selling price of the capital asset;
  2. the acquisition cost; and
  3. the amounts invested in the asset.
- All the interrelated pieces of evidence allow the court to find that the construction expenses are related to the amounts invested during the asset holding period.
- The court findings are based on the loan usage being monitored by the bank according to statements received from a certified construction engineer measuring the investment and making recommendations for more funds to be released.

However, with respect to a mortgage loan that was made in a single payment without holding the person

accountable for its use, the court found that the case had no evidence to prove that this loan amount, too, was spent on building the house and not for any other purpose, so the person was not permitted to deduct the amount from the tax base.