

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D18/99

Salaries Tax – whether the housing allowance is exempt from salaries tax assessment – Inland Revenue Ordinance, section 9(1)(a).

Panel: Andrey Eu Yuet Mee SC (chairman), Vernon F Moore and William Zao Sing Tsun.

Date of hearing: 10 May 1999.

Date of decision: 31 May 1999.

The taxpayer came to Hong Kong under a contract of employment with salaries of \$46,000 with housing allowance of \$20,000 a month. He rented a flat for \$16,500 a month from June 1996. The taxpayer paid \$208,011 rent for the year of assessment 1997/98 and he was refunded \$240,000 by his employer. The assessor included the whole allowance, that is, \$240,000 as taxable income and the taxpayer appealed.

Held:

The test is whether the housing allowance was paid as a refund, that is, a repayment or a reimbursement. This depends on the nature of the payment itself and thus the intention on the parties when they enter into the contract of employment (D62/92, D19/95, D34/96, D21/98, D92/95 referred).

The contract of employment does not provide that the housing allowance will not be payable if the employee does not incur any housing expenses or incurs less than the allowed amount. The taxpayer never refunded any surplus to his employer (D92/95 distinguished).

Appeal dismissed.

Cases referred to:

D62/92, IRBRD, vol 8, 85
D19/95, IRBRD, vol 10, 157
D34/96, IRBRD, vol 11, 497
D21/98, IRBRD, vol 13, 203
D92/95, IRBRD, vol 11, 173

Jennifer Chan for the Commissioner of Inland Revenue.
Taxpayer in person.

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Decision:

1. The Taxpayer objected to the additional tax assessment raised on him for the year of assessment 1997/98. This relates to \$20,000 a month which the Taxpayer received under his contract of employment as 'housing allowance'. The issue is whether this sum or any part thereof is exempt from tax under section 9(1)(a) of the Inland Revenue Ordinance ('the IRO').

The facts

2. The following facts are not in dispute.

3. The Taxpayer was residing with his family in Country A. He entered into a contract of employment with Company B ('the Employer'). His appointment would be effective on 18 April 1996. His salary would be \$46,000 a month plus a performance bonus as defined. Details of the bonus do not concern us. The contract of employment also stated 'Company B will pay you a housing allowance of \$20,000 a month'.

4. The Taxpayer came to Hong Kong. He took up employment as from 18 April 1996. For the first 6 weeks or so, he and his family resided with his mother.

5. The Taxpayer looked for suitable accommodation and eventually signed a tenancy agreement with his landlord for the flat known as the Property. Pursuant to the tenancy agreement, the rental was \$16,500 a month. The tenant was responsible for the management fees. The tenancy commenced from 1 June 1996.

6. For the year 1997/98, the Employer filed a tax return which included \$240,000 (\$20,000x12) housing allowance as particulars of income accruing during the period. It also described the Property as quarters provided by the Employer.

7. The Taxpayer declared that the \$240,000 was refunded to him by the Employer and he paid \$208,011 rent to the landlord.

8. At one stage, the assessor raised an additional tax assessment of \$39,625. The Taxpayer objected. By the determination dated 29 January 1999, the Commissioner of Inland Revenue varied the additional tax to \$29,184. This assessment included the whole allowance of \$240,000 (\$20,000x12) as taxable income.

9. The Taxpayer lodged his notice of appeal dated 26 February 1999. He enclosed with his notice, an amended employer's return, bearing a faxed date of 5 February 1999 where the \$240,000 housing allowance was split as follows. \$208,011 (which was the rent and management fees paid) was rent refunded and the balance of \$31,989 (\$240,000 -

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\$208,011) was taxable income. In addition, he also enclosed a letter dated 5 February 1999 from the Employer which sought to reverse the effect of an earlier letter. An earlier letter dated 16 July 1998 from the Employer to the Commissioner said this:

‘According to his employment contract, he was entitled to get the monthly allowance for his flat at \$20,000. We do not elaborate on the control exercised by our company to ensure the housing allowance was actually expended by him in the payment of rent.’

This later letter dated 5 February 1999 from the Employer addressed to the Commissioner said this:

‘According to the usage of his housing allowance, it is controlled by our company. He has to use this allowance for renting his apartment.’

The Revenue’s representative said that they never received the two documents dated 5 February 1999 from the Employer. The Taxpayer accepted that these documents were not sent by the Employer to the Revenue but were given to him and he enclosed them with his notice of appeal.

The evidence

10. The Taxpayer gave evidence himself and called no other witness. He explained to us that the housing allowance was a crucial consideration for an overseas employee like himself deciding whether to take up employment in Hong Kong. Since the contract of employment was negotiated whilst he was in Country A, he could not know in advance what the rent would be. \$20,000 was agreed as representing the fair market rental for a flat suitable for his family of 5 persons. He stayed with his mother initially so no rental was incurred for the first 6 weeks of the contract of employment. However he would need a reasonable time to look for a suitable flat and it would be common in this situation for hotel expenses to have been incurred. When he found the Property, he set up the bank giro system specifically for the payment of the rent in advance every month. His Employer reimbursed him for the rental in arrears at the end of every month together with the rest of his entitlement under the contract of employment. Thus he said that the payment of \$208,011, the rent plus the management fee, was in substance a repayment or a refund within the meaning of the IRO.

11. In answer to a question from the Board, he said that if he had continued to stay with his mother and no rent was incurred, he would have declared and returned the \$20,000 housing allowance for the Employer.

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The Law

12. The onus is on the Taxpayer to persuade us that the determination was incorrect. In this respect, we note that the determination was in error as to the address of the Property, but this does not affect the issue we have to decide.

13. The Revenue's representative cited to us the usual authorities on this matter. We were referred to the relevant parts of sections 8(1), 9(1)(a), 9(1A) and 9(2) of the IRO as well as **D62/92**, IRBRD, vol 8, 85, **D19/95**, IRBRD, vol 10, 157, **D34/96**, IRBRD, vol 11, 497 and **D21/98**, IRBRD, vol 13, 203. The Taxpayer also referred us to **D92/95**, IRBRD, vol 11, 173.

14. The principles in these cases are quite clear. Housing allowance is taxable as income unless it comes within the exemptions in section 9(1A). Section 9(1A)(a) reads:

'(a) Notwithstanding subsection (1)(a), where an employer or an associated corporation –

(i) pays all or part of the rent payable by the employee; or

(ii) refunds all or part of the rent paid by the employee,

such payment or refund shall be deemed not to be income.'

15. In the present case, the Employer did not pay all or any part of the rental to the landlord. The Taxpayer argued that the payment by the Employer to him was a refund. Refund is an ordinary English word. The cases refer to the meaning in the Concise Oxford Dictionary, that is 'pay back' or 'reimburse'.

16. In **D92/95**, which was cited by the Taxpayer, the material portion of the employment contract stated: 'Your commencing salary will be at the rate of \$28,500 per month which would include a contribution towards the cost of housing ... Until you found alternative accommodation, we will meet reasonable hotel expenses incurred, up to a maximum period of three weeks.' The Board accepted the taxpayer's evidence that prior to the taxpayer coming to Hong Kong, it was not possible to agree on the amount of the contribution towards the cost of housing. Later the taxpayer came to Hong Kong and entered into a tenancy agreement for a flat at \$15,000 a month. A copy of the lease was shown to the employer. The taxpayer and his employer then orally agreed to a contribution of \$15,000 a month. At the end of each month or at the latest before the end of each year of assessment, all relevant rent receipts for the flat were submitted by the taxpayer to the employer. On the facts of the case, the Board found that the payment of \$15,000 per month made by the employer to the taxpayer amounted to refund of rent. The Board in that case added that it was not a case like other typical precedents (see example **D62/92**) where the alleged rental refunds were well in excess of the rental payments.

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Reasons for decision

17. The law on this matter is clear. The test is whether the housing allowance was paid as a refund, that is, a repayment or a reimbursement. This does not depend solely on the method or the timing of payment (although such factors may be relevant as showing intention), but on the nature of the payment itself. This in turn depends on the parties' intention at the time they enter into the contract of employment.

18. First, we must look at the contract of employment. This provides for \$20,000 housing allowance. There is nothing in the contract to indicate that this amount or any part thereof is not payable if the employee does not incur this sum for his housing. There is no provision for the Employer to control the use of the money. There is no provision for any refund or repayment of this amount if the Taxpayer has not incurred any housing expenses or has incurred less than the amount. In short, the Employer is obliged to pay the full amount as part of the contractual arrangement. In answer to a question from the Board, the Taxpayer claimed that he would have returned this sum to the Employer if he had continued to stay with his mother and thus saved rental expenses. We do not accept this evidence and we note that he never refunded the surplus to his Employer when he had only incurred housing expenses of \$208,011 and not \$240,000 in the year. That is the very distinction which the Board noted in **D92/95**, a case cited by the Taxpayer to us.

19. In addition, we note that for the first 6 weeks or so, the Taxpayer incurred no rental. But he was still paid the \$20,000 a month housing allowance. Although this was in respect of an earlier tax year (the Taxpayer said that he did declare that sum as taxable income), the legal position was the same. The nature of the payment was governed by the same contract of employment. The Employer paid the \$20,000 housing allowance because it was bound by a term of the contract of employment to do so, not because the Employer had aid some housing expenses. Similarly the Taxpayer was entitled to this sum as part of his income under a term of the contract of employment, irrespective of whether he has incurred housing expenses of this amount.

20. Thus, it is quite clear that the housing allowance of \$20,000 was not intended or paid as a refund within the meaning of section 9(1A)(ii). In the circumstances, we would dismiss the appeal and uphold the determination as to the amount of the additional tax.