Case No. D40/12

Salaries tax – home loan interest deduction – section 26E of the Inland Revenue Ordinance (‘the IRO’) – whether subsequent withdrawals constituted re-borrowings from the bank – nature of subsequent withdrawals – computation of interest disallowed.

Panel: Albert T da Rosa, Jr (chairman), Chau Cham Kuen and Chow Mun Wah Anna.

Date of hearing: 13 June 2012.
Date of decision: 3 December 2012.

The Appellants are husband and wife. They acquired a property as joint owners. They took out mortgage loan and a further mortgage loan with the property as security. The two loans are collectively referred to as Home Smart Accounts. The Appellants were allowed to deposit additional funds into the Home Smart Accounts to save interest and withdraw extra amounts from them to meet their financial needs.

They objected to the salaries tax assessment. They claimed that the amount of home loan interest allowed for deduction was not correct. The Appellants’ claimed that the interests paid for amounts withdrawn from the Home Smart Accounts subsequent to the drawdown of the loans should qualify for deduction as home loan interest.

The issue for the Board to decide is whether the withdrawals made subsequent to the drawdown of the loans qualify as home loan and the amount of interest paid for the loans that should be allowed as home loan interest deduction.

Held:

1. To succeed in the claim for home loan interest deduction, the taxpayer must establish that the conditions under section 26E of the IRO are satisfied. Pursuant to sections 26E(1) and 26E(9) of the IRO, only the loan which is applied wholly or partly for in the acquisition of a dwelling can be regarded as a home loan and the interest paid on a home loan is deductible as home loan interest. Section 26E(3)(a) further provides that if the home loan was not applied wholly for the acquisition of the dwelling, only so much of the interest as is reasonable in the circumstances will be allowed as a home loan interest deduction.

2. Once deposits went into the Home Smart Accounts and there were then withdrawals for other purposes, the subsequent withdrawals increased the

loan balances and constituted re-borrowings from the bank. The Appellants' intention of making the repayments, the size and change of the loan balance are irrelevant in deciding the nature of the subsequent withdrawals (D103/89, IRBRD, vol 6, 379 followed).

3. The 'acquisition of a dwelling' takes place as soon as a person completes the purchase from the vendor and pays the full purchase price even though the dwelling has been mortgaged to a bank. Therefore, the amounts withdrawn from the Home Smart Accounts subsequent to the drawdown of the loans were not for the acquisition of the property. As a matter of fact, they were re-borrowings raised from the bank for other non-qualifying purposes such as honouring various cheque payments and paying loan interests (D123/01, IRBRD, vol 6, 915 followed).

4. It was the presumed intention between the bank and the Appellants that repayments and re-borrowings could be made to and from the Home Smart Accounts from time to time, without any specific indication as to which loan or re-borrowing was in respect of which repayment. Following the Clayton's rule, a repayment from the Appellants should be allocated to their earliest debt in the Home Smart Accounts based on the simple first-in, first-out notion. It follows that none of the subsequent withdrawals should have been repaid by the total deposits made into the Home Smart Accounts (Devaynes v Noble: Clayton's Case (1816) 35 ER 781 followed).

5. The interest disallowed was for the months in which the deposits into the Home Smart Accounts were less than withdrawals and the upcoming months in which the cumulative deposits were less than the cumulative withdrawals based on the following apportionment formula:

$$\text{Interest paid for the month} \quad \text{x} \quad \frac{\text{Excess withdrawal}}{(\text{opening + closing loan balance}) \div 2}$$

Such computation was made on the assumptions that the amounts deposited into the Home Smart Accounts were used to repay the other amounts withdrawn therefrom (that is other than the drawdown of the loans) in the first place. It followed that for the month:

(i) where the deposits / cumulative deposits exceeded the withdrawals / cumulative withdrawals, no interest was disallowed; and

(ii) where the reverse happened, interest paid on the excess withdrawal was disallowed.

In computing the amount of disallowed interest for the month, the ratio of the excess withdrawal against the simple average of the opening and closing balance of the outstanding loan of the month was adopted to apportion the interest. As a result the computation is favourable to the Appellants since not all the deposits are regarded as repayment of the loans.

Appeal dismissed.

Cases referred to:

D123/01, IRBRD, vol 16, 915
D18/02, IRBRD, vol 17, 483
D103/89, IRBRD, vol 6, 379
Devaynes v Noble: Clayton's Case (1816) 35 ER 781

Taxpayer in person.
To Yee Man and Chan Wai Yee for the Commissioner of Inland Revenue.

Decision:

Introduction

1. Mr A and Ms B (collectively with Mr A 'the Appellants') are husband and wife. They objected to the salaries tax assessment for the year of assessment 2007/08 raised on them. The Appellants claim that the amount of home loan interest allowed for deduction was not correct.

2. By the determination ('the Determination') dated 30 September 2011 by the Deputy Commissioner of Inland Revenue ('the CIR') upheld the relevant salaries tax assessment for the year of assessment.

3. All documents submitted to the Board including all previous correspondence between the Appellants and the Respondent were in English.

4. The parties wished to use the Cantonese dialect of the Chinese language for all oral proceedings before the Board but to continue to use English for all written elements without translation into Chinese.

5. By consent, the hearing was conducted on the following basis:

5.1. oral evidence and submissions were in the Cantonese dialect of the Chinese language without English interpretation;

5.2. written submissions were in English;

5.3. there was no translation of documents in one of the official languages to the other; and

5.4. the Board was to deliver its decision in English.

6. At the hearing on 13 June 2012:

6.1. Mr A represented Ms B, gave evidence on affirmation, and was cross-examined.

6.2. After the Respondent had made its closing submission, the Respondent was directed to file written supplementary submission on the legislative background leading to the enactment and subsequent amendments of section 26E of the Inland Revenue Ordinance ('the IRO') to shed light on the legislative intent regarding the scheme for allowing deduction of interest and the Appellants were given leave to reply to the issues raised in the Respondent's supplementary submission.

6.3. Apart from the matters to be dealt with as per paragraph 6.2 herein, the Appellants were given the choice of making their closing submissions orally on that day or to make oral or written submission on the next day (as 2 days had been fixed for the hearing). The Appellants chose to make oral submission there and then closed their case subject only to the matters referred to in paragraph 6.2 herein.

7. On 20 June 2012 by email sent at 4:45 p.m., the Appellants purported to file submission and to adduce further evidence without leave in further answer to the closing submission of the Respondent. The Appellants' submission on 20 June 2012 is therefore ignored.

8. On 20 June 2012, pursuant to the direction of the Board, the Respondent filed its supplementary submissions.

9. On 22 June 2012 by email sent at 0:17 a.m. the Appellants gave their comments on the Respondent's supplementary submission.

The facts

10. It is not disputed that the Appellants Mr A and Ms B are husband and wife.

11. From the documents presented we find as follows:

11.1. On 13 July 2005, the Appellants acquired a property known as Flat C ('the Property') as joint owners.

11.2. On the same day, they took out a mortgage loan of $2,065,000 ('Loan 1') from Bank D and drawn down in Loan 1 Account, with the Property as the security.

11.3. On 10 January 2008, they took out a further mortgage loan of $2,590,000 ('Loan 2') (including the outstanding amount of Loan 1) from Bank D (Loan 1 and Loan 2 are hereinafter referred to as 'the Loans' collectively) and drawn down in Loan 2 Account, with the Property as the security. Loan 1 Account and Loan 2 Account are collectively referred to as the Home Smart Accounts, which combined mortgage and checking accounts into one. On the same day, the opening balance of Loan 2 Account was wholly applied to repay the outstanding balance of Loan 1.

11.4. The Appellants were allowed to deposit additional funds into the Home Smart Accounts to save interest and withdraw extra amounts from them to meet their financial needs.

11.5. At the relevant times, monies were deposited into and withdrawn from the Home Smart Accounts.

11.6. For the year of assessment 2007/08, the total of the interests paid under the Home Smart Accounts was $67,986.77.

11.7. Total deposits made into the Home Smart Accounts for the period from 13 July 2005 to 31 March 2008 are as follows:

Period	Loan 1 Account	Loan 2 Account
	$	$
13-07-2005 – 28-02-2007	1,248,747.51	-
March 2007	59,573.30	-
May 2007	120,523.20	-
June 2007	207,887.50	-
July 2007	40,000.00	-
September 2007	35,000.00	-
October 2007	30,000.00	-
November 2007	130,000.00	-
	622,984.00	-
February 2008	-	800,000.00
March 2008	-	200,000.00
Total	1,871,731.51	1,000,000.00

11.8. The letter dated 26 October 2011 issued by Bank D to the Appellants stated the following:

‘ … [the Home Smart Accounts have] overdraft and deposit facilities in addition to the mortgage loan. Any payment/deposit will offset the principal solely while interest will accrue daily based on current outstanding balance and be capitalized at each month end.’

11.9. The Property was used in the relevant year of assessment by the Appellants as their place of residence.

Appellants’ contention

12. In the Appellants’ notice of appeal, they claimed that the interests paid for amounts withdrawn from the Home Smart Accounts subsequent to the drawdown of the Loans should qualify for deduction as home loan interest. In brief, their grounds of appeal are as follows:

12.1. For the period from 13 July 2005 to 7 February 2007, they made total deposits of $1,032,500 ($2,065,000 - $1,032,500.01) into Loan 1 Account in order to reduce interest. The total deposits exceeded the total instalments of $228,900 (that is $10,900 x 21 months) due to Bank D for that period by $803,600 (that is $1,032,500 - $228,900).

12.2. On 8 January 2008, they were persuaded by the Bank D’s staff to take out Loan 2 in order to get a better interest rate (from P - 2.5% for Loan 1 to P - 2.9% for Loan 2).

12.3. There was no re-grant of loan under the Home Smart Accounts by reasons that:

(a) They made the deposits for saving bank interest whilst the size of the Loans remained the same.

(b) They merely withdrew their deposits previously made into the accounts. No extra amount or re-borrowing from Bank D was taken out.

(c) The balance of the Loans should not be treated as having been increased by the subsequent withdrawals. If deposits had not been made by them previously, the loan balances would have been larger.

12.4. They entered into binding contract with Bank D and made deposits into the Home Smart Accounts in order to save interest. This was desirable to both of them (by paying less interest) and the Revenue (by levying more tax). From their point of view, it is ridiculous and unacceptable for the Revenue to reject their objection.

The issue

13. The issue for the Board to decide is the amount of home loan interest in respect of the Property that should be allowed to the Appellants for the year of assessment 2007/08.

The relevant statutory provisions

14. Deduction of home loan interest is governed by section 26E of the Inland Revenue Ordinance ('IRO') which has the following legislative history:

14.1. The granting of a concessionary deduction for home loan interest under salaries tax was first proposed in the 1998-99 Budget. The 1998 Bill introduced, inter alia, section 26E of the IRO to provide deductions for home loan interest, by which any interest payment made in respect of a home loan will become deductible for 5 years of assessment, subject to an annual maximum of $100,000. On 7 April 1998, the 1998 Bill was passed.

14.2. On 21 November 2001 section 26E of the IRO was amended to raise the tax-deduction ceiling for home loan interest to $150,000 for the years of assessment 2001/02 and 2002/03.

14.3. On 12 May 2004 section 26E was amended to give an extension of entitlement period for home loan interest deduction from five years to seven years. On 24 May 2006 section 26E was amended to give an extension of limit for home loan interest deduction from seven years to ten years.

15. The research in the supplementary submission submitted by the Respondent on the legislative background of section 26E of the IRO did not include anything which definitively and expressly showed that subsequent revolving loans will be treated as part of the original home loan.

16. We note that on 16 March 1998 and 23 March 1998 respectively, two meetings were held by the Bills Committee to study the 1998 Bill. The minutes of the first meeting stated the following in relation to the home loan interest deduction:

' Application of the concession on home loan interest

4. Noting that under [1998 Bill], owner-occupiers could claim up to a maximum mortgage interest deduction of $100,000 per year in respect of

a dwelling in any five tax years, a member sought clarification on the basis upon which the duration of five years was arrived at. The Commissioner of Inland Revenue ("CIR") explained that in general, the burden of interest on home buyers would be heavier at the threshold of mortgage because of the large amount of principal involved which would gradually diminish as the principal reduced over time. The proposed tax concession for five years would serve as financial relief to home buyers, in particular at the initial stage of mortgage. To optimize the benefits of the concession, arrangement had been made for taxpayers to choose the period within which the deduction should apply taking into account their individual circumstances. For example, some existing home owners might wish to exercise the concession at a later stage when they acquired a new home. …

Discretion of [CIR]

9. Mr Eric LI considered the scope of [CIR's] discretionary power under section 26E was too wide in view of the numerous scenarios arising from the deduction of home loan interest, … which required special consideration by [CIR]. While acknowledging the member's concern, [CIR] remained of the view that the discretion was necessary since not all scenarios could be listed out before the implementation of [the 1998 Bill] and the discretion would enable [CIR] to deal with different cases according to individual merits. [CIR] emphasized that [CIR's] decision was not final and adjudication from the Board of Review could be sought in the event of disputes. …'

17. In the legislation, the specific scenario for home loan interest deduction where traditional mortgage loan accounts combined with other banking facilities was not expressly dealt with. However, in view of the numerous scenarios arising from the home loan interest deduction, it was necessary for the Revenue to exercise discretion to deal with different cases according to their individual merits. The reasonableness of the exercise of such discretion is guarded by the appeal process to this Board.

18. Insofar as relevant, section 26E of the IRO contained the following provisions:

18.1. Section 26E(1) provides for the deduction of home loan interest as follows:

' *Subject to the other provisions of this section and to section 26F, where a person pays during any year of assessment any home loan interest for the purposes of a home loan obtained in respect of a dwelling which is used at any time in that year of assessment by the person exclusively or partly as his place of residence, a deduction in respect of the home loan interest shall be allowable to that person for that year of assessment.*'

18.2. Section 26E(3)(a) provides for the apportionment of the allowable home loan interest if the loan is not applied wholly for the acquisition of the dwelling:

‘ *Where any home loan interest is paid by a person during any year of assessment for the purposes of a home loan obtained in respect of a dwelling which is used at any time in that year of assessment by that person exclusively or partly as his place of residence, but the loan was not applied wholly for the acquisition of the dwelling, the deduction allowable to the person under subsection (1) for that year of assessment in respect of the home loan interest paid shall be such part of the amount of the home loan interest paid as is reasonable in the circumstances of the case.*’

18.3. Section 26E(9) defines the terms ‘home loan’ and ‘home loan interest’ as follows:

‘*“home loan” (居所貸款), in relation to a person claiming a deduction under this section for any year of assessment, means a loan of money which is –*

(a) applied wholly or partly for the acquisition of a dwelling which –

(i) during any period of time in that year of assessment is held by the person as a sole owner, or as a joint tenant or tenant in common; and

(ii) during that period of time is used by the person exclusively or partly as his place of residence; and

(b) secured during that period of time by a mortgage or charge over that dwelling or any other property in Hong Kong;

“home loan interest” (居所貸款利息), in relation to a person claiming a deduction in respect of a dwelling under this section, means interest paid by the person as a sole owner, or as a joint tenant or tenant in common of the dwelling for the purposes of a home loan to –

(b) a financial institution;

…’

18.4. Section 68(4) of the IRO provides that in the hearing and disposal of appeals to the Board:

‘ *The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.*’

Application in other cases

19. In D123/01, IRBRD, vol 16, 915, the Board stated the following at paragraphs 23 to 25 therein in relation to the ‘acquisition of a dwelling’ and the definition of ‘home loan’ [R2/17]:

‘ *23. … We think that the “acquisition of a dwelling” by a person is complete as soon as he completes the purchase from the vendor and pays the full purchase price, notwithstanding that the whole or part of such purchase price has been borrowed from a bank on mortgage on the security of the property in question. It is true that what normally happens in the majority of cases is that the purchaser of a property will finance his purchase by obtaining a loan from the bank by mortgaging the same property with the completion of the purchase and the creation of the mortgage occurring simultaneously. On the other hand, there is nothing unusual in a case where a person purchases a property as a dwelling entirely with his own funds but subsequently decides to mortgage the same property to obtain finance. In such a case, the “loan of money” would not have been “applied wholly or partly for the acquisition of a dwelling” within the definition of “home loan” aforesaid. In any event, in ordinary parlance, one would not say that one had not completely purchased a property simply because the same had been mortgaged to a bank.*

24. Strictly speaking, when a person substitutes an original mortgage of his home by a subsequent mortgage, in order to obtain a more favourable rate of interest or for some other reason, the Commissioner may not be obliged under the definition of “home loan” to continue granting that person the benefit of the “home loan interest” deduction. Nevertheless, as a matter of policy and practice, he still grants it as a concession.

25. The position of a person obtaining an additional loan by a further charge on the property which is his dwelling is different. In order to qualify for the concession, he has to prove that the additional loan was “applied wholly or partly for the acquisition of a dwelling”.’

20. In D18/02, IRBRD, vol 17, 483, the taxpayer and his wife financed the purchase of their dwelling mainly by way of a loan from a finance company. Thereafter, they obtained a new loan from a bank and repaid the old loan. The Revenue allowed a

deduction of home loan interest on the basis of the unpaid principal of the old loan replaced by the new loan. The Board found that the formula adopted by the Commissioner in the computation of the home loan interest was fair and reasonable in all the circumstances.

21. In D103/89, IRBRD, vol 6, 379, the taxpayer purchased certain properties and borrowed money from banks for this purpose. In the course of time the fixed property loans were repaid and the properties re-mortgaged to secure an overdraft account. The taxpayer operated the overdraft account and paid substantial sums into the account to reduce its amount and paid out sums which increased the amount of the overdraft. The taxpayer claimed as a deduction from his taxable income for personal assessment purposes all of the interest accrued on his overdraft account. In dismissing the taxpayer's appeal, the Board held at paragraph 14 therein:

> ' *14. What has to be established under the proviso of section 42 [of the IRO] is the purpose for which the money was borrowed. The original overdraft of $250,000 was unquestionably for the purpose of producing chargeable income under section 42(1) since that sum went to discharge the original loan. But once deposits of cash went into that account and there were then withdrawals for other purposes, it is difficult to see how it could be said that the borrowings were wholly for the purpose of producing chargeable income. And when the entire borrowing was repaid, however temporarily, and the account was operated for a variety of purposes, it is then up to the Taxpayer to demonstrate that the withdrawals nevertheless were for the purpose of producing chargeable income under section 42(1). This he has totally failed to do. …*'

The Revenue's submission

22. To succeed in the claim for home loan interest deduction, the taxpayer must establish that the conditions under section 26E of the IRO are satisfied. Pursuant to sections 26E(1) and 26E(9) of the IRO, only the loan which is applied wholly or partly for the acquisition of a dwelling can be regarded as a home loan and the interest paid on a home loan is deductible as home loan interest. Section 26E(3)(a) further provides that if the home loan was not applied wholly for the acquisition of the dwelling, only so much of the interest as is reasonable in the circumstances will be allowed as a home loan interest deduction.

23. The Respondent submitted that notwithstanding that a loan may originally have been obtained for the purchase of a dwelling, any subsequent re-grant of it or increase in the principal amount that is not applied to a qualifying purpose cannot be said to have been similarly obtained. Where there are re-borrowings subsequent to repayment of (all or part of) the original loan and the funds applied to non-qualifying purposes, then no deduction is allowable for the interest paid on that part of the outstanding loan balance. This proposition was also endorsed by the Board in D123/01 and D18/02 [paragraphs 19 and 20 herein].

24. In the present case, there was no dispute that the Appellants resided in the Property at the relevant times. The Respondent accepted that Loan 1 is a home loan. The loan was obtained on 13 July 2005 when the purchase price was paid and the Property was assigned to the Appellants. On 10 January 2008, the outstanding principal of Loan 1 was wholly repaid by Loan 2 in the same amount. On the authority of D123/01 [paragraph 19 herein], Loan 2 was not a 'home loan' within the meaning of section 26E(9) of the IRO as no part of it was applied for the acquisition of the Property. Nevertheless, the Respondent has elected, for the present proceedings by concession, that Loan 2 used to repay Loan 1 is also a home loan.

25. There is no dispute that the Appellants deposited funds into the Home Smart Accounts with a view to saving interest. The central issues in this appeal still remain

25.1. whether the withdrawals made subsequent to the drawdown of the Loans qualify as home loan and

25.2. the amount of interest paid for the Loans that should be allowed as home loan interest deduction.

Whether the subsequent withdrawals qualify as home loan?

26. The Appellants claimed that there was no re-borrowing from Bank D on the grounds that they merely withdrew the monies previously deposited by them into the Home Smart Accounts for saving interest; that the loan size remained the same and that the loan balance would have been larger but for their deposit of monies [paragraph 12 herein].

27. As explicitly provided in the loan facilities letters and as confirmed by Bank D [paragraph 11.8 herein], any repayment made by the Appellants in excess of all instalments and amounts due to Bank D were to repay the outstanding principal of the Loans and available for re-borrowing [clause 7(b) to (d)] and interest was payable on the outstanding balance of the Loans (clause 3). Thus, we find that

27.1. the repayments made by the Appellants became Bank D's funds for which the Appellants no longer had proprietary interest.

27.2. the re-borrowing facilities extended to the Appellants allowed them to withdraw the excess amount of repayment from the Home Smart Accounts.

28. As in D103/89 [paragraph 21 herein], we find that once deposits went into the Home Smart Accounts and there were then withdrawals for other purposes, the subsequent withdrawals increased the loan balances and constituted re-borrowings from Bank D. The Appellants' intention of making the repayments, the size and change of the loan balance are irrelevant in deciding the nature of the subsequent withdrawals.

29. As held in D123/01 [paragraph 19 herein], the 'acquisition of a dwelling' takes place as soon as a person completes the purchase from the vendor and pays the full purchase price even though the dwelling has been mortgaged to a bank. Therefore, the amounts withdrawn from the Home Smart Accounts subsequent to the drawdown of the Loans were not for the acquisition of the Property. As a matter of fact, they were re-borrowings raised from Bank D for other non-qualifying purposes such as honouring various cheque payments and paying loan interests.

30. We find that withdrawals made subsequent to the drawdown of the Loans do not qualify as home loan.

The amount of deductible home loan interests?

31. In Devaynes v Noble: Clayton's Case (1816) 35 ER 781 (which created the well-known common law presumption known as the 'first-in, first-out rule' or the 'Clayton's rule' to determine the effect of payments from an account which presumption will normally apply in the absence of evidence of any other intention) Grant MR said at page 793:

> '*… this is the case of a banking account, where all the sums paid in form one blended fund, the parts of which have no longer any distinct existence. … In such a case, there is no room for any other appropriation than that which arises from the order in which the receipts and payments take place, and are carried into the account. Presumably, it is the sum first paid in, that is first drawn out. It is the first item on the debit side of the account, that is discharged, or reduced, by the first item on the credit side. The appropriation is made by the very act of setting the two items against each other. … When there has been a continuation of dealings, in what way can it be ascertained whether the specific balance due on a given day has, or has not, been discharged, but by examining whether payments to the amount of that balance appear by the account to have been made? You are not to take the account backwards, and strike the balance at the head, instead of the foot, of it.*'

32. On the available evidence, it was the presumed intention between Bank D and the Appellants that repayments and re-borrowings could be made to and from the Home Smart Accounts from time to time, without any specific indication as to which loan or re-borrowing was in respect of which repayment. Following the Clayton's rule [paragraph 31 herein], a repayment from the Appellants should be allocated to their earliest debt in the Home Smart Accounts based on the simple first-in, first-out notion. As such, total deposits of $1,871,731.51 made into Loan 1 Account for the period from 13 July 2005 to 10 January 2008 and $1,000,000 made into Loan 2 Account for the period from 10 January 2008 to 31 March 2008 [paragraph 11.7 herein] should have been wholly applied to repay the drawdown of the Loans of $2,065,000 and $1,630,546.15 respectively. It follows that none of the subsequent withdrawals should have been repaid by the total deposits made into the Home Smart Accounts.

33. Clause 3 of the loan facility letters provided that interest was accrued from day to day and calculated on the daily outstanding balance of the Loans. On the basis of the Clayton's rule and following the decision of D103/89 [paragraph 21 herein], the interest incurred for each of the subsequent withdrawals should be disallowed by tracing all the way from the date of withdrawal to the date of repayment. However, the Respondent submitted that such calculation method would be arithmetically difficult, if not impossible. The Respondent has adopted a pragmatic way to compute the amount of interest to be disallowed. The Respondent further submitted that, the interest disallowed was for the months in which the deposits into the Home Smart Accounts were less than withdrawals and the upcoming months in which the cumulative deposits were less than the cumulative withdrawals (described as 'excess withdrawal') based on the following apportionment formula:

$$\text{Interest paid for the month} \quad \times \quad \frac{\text{Excess withdrawal}}{(\text{opening} + \text{closing loan balance}) \div 2}$$

34. Such computation as suggested by the Respondent has departed from the Clayton's rule and was made on the assumptions that the amounts deposited into the Home Smart Accounts were used to repay the other amounts withdrawn therefrom (that is other than the drawdown of the Loans) in the first place. It followed that for the month:

34.1. where the deposits / cumulative deposits exceeded the withdrawals / cumulative withdrawals, no interest was disallowed; and

34.2. where the reverse happened, interest paid on the excess withdrawal was disallowed.

35. In computing the amount of disallowed interest for the month, the ratio of the excess withdrawal against the simple average of the opening and closing balance of the outstanding loan of the month was adopted by the Respondent to apportion the interest.

36. On such apportionment basis, the amount of disallowed interest is $14,800 and the amount of home loan interest allowable to each of the Appellants is $26,593. As a result, the computation is favourable to the Appellants since not all the deposits are regarded as repayment of the Loans.

37. We adopt such formula and calculations and agree that such basis of calculation is fair to the Appellants.

Conclusions

38. The appeal is therefore dismissed and the assessment as revised in the Determination is confirmed.