HCIA 2/2002

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE

INLAND REVENUE APPEAL NO. 2 OF 2002

BETWEEN

COMMISSIONER OF INLAND REVENUE — Appellant

and

PETER LESLIE PAGE — Respondent

Coram: Mr Recorder Edward Chan, SC in Court
Date of Hearing: 23 September 2002
Date of Judgment: 14 November 2002

J U D G M E N T

---

1. This is an appeal by way of case stated by the Commissioner of Inland Revenue against the decision of the Board of Review under section 69 of the Inland Revenue Ordinance.

2. The matter arose out of a determination by the acting Deputy Commissioner of Inland Revenue dated 24 July 2001. For the year of assessment 1998/1999, the respondent taxpayer claimed that certain sum paid by his employer, Camp Dresser and

McKee International Inc. (hereinafter called "the employer") was rental refund, and as such was not chargeable to tax. The assessor rejected the taxpayer's claim and raised a tax assessment for the year 1998/1999 on the basis that the said sum paid by the employer was cash allowance and therefore chargeable to tax. The taxpayer objected to the assessment but his objection was overruled by the Acting Deputy Commissioner of Inland Revenue. The taxpayer appealed to the Board of Review (hereinafter called "the Board") and the Board allowed the taxpayer's appeal holding by majority that the sum in question was a refund of rent, and as such was not chargeable to tax. The Commissioner requested the Board for a case stated and appealed to this Court. The 2 questions raised for the determination of this Court are:

(1) Whether the Board erred in law and misconstrued the terms and effects of the Resident Site Staff Agreement dated 12 July 1997 in concluding that the intention of the parties was to provide a place of residence to the taxpayer through refund of rent subject to a cap.

(2) Whether on the facts found, the Board by majority erred in law in concluding that the housing benefit of $410,040.00 paid by the employer to the taxpayer was rental refund and not cash allowance.

3. The taxpayer was employed under an agreement dated 12 July 1997 and many of the detailed terms of employment were set out in a document titled "Appendix on terms of employment for resident site staff'. For the purpose of this appeal, the relevant clauses are clauses 3.5 and 5.1 & 5.2. They are in the following terms:

"3.5 The Consultant [i.e. employer] may deduct from the salary of the person engaged any amount that it may have overpaid him; any advances of salary; any charges that the person engaged may have incurred in respect of any facilities or benefits provided to the person engaged or his family by the Consultant including, but not limited to, those facilities or benefits referred to in this Appendix, and any other debt whatsoever that may arise and become due from the person engaged to the Consultant either during the period of his employment or upon his leaving the service."

"5.1 The person engaged whose substantive monthly salary is on or above point 34 of the Master Pay Scale is, eligible for a **Housing Benefit** set out in 5.2.

5.2 The cap in respect of housing benefit for an individual on the Resident Site Staff shall be:

Government pay scale point	Cap (HK$ per month)
MPS 45-D1	30,500

MPS 41-44	22,300
MPS 38-40	20,300
MPS 34-37	18,200

The amount shall be adjusted on the 1 April immediately subsequent to the date of commencement of this Agreement, in accordance with the movements of the corresponding scale of the Home Financing Allowance for Civil Servants. **The person engaged shall submit to the Consultant the evidence for the actual payment they paid for the housing**." (emphasis added)

4. In the year of assessment in question, the salary of the taxpayer was such that he would be entitled to Housing Benefit of MPS 45-D1 scale, i.e. up to a cap of HK$30,500.00 per month subject to adjustment. In the year of assessment in question the taxpayer had paid the total sum of $453,887.00 as rent, rates and management fees, and in respect of these items, he was paid by the employer the sum of HK$410,040.00, which the taxpayer would claim as a rental refund by the employer, and which the Commissioner would contend was a cash allowance given to him by the employer.

5. Sections 9(1) & (1A) of the Inland Revenue Ordinance provides:

(1) Income from any office or employment includes –

(a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others, except – .....

(1A)(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;

(b) a place of residence in respect of which an employer or associated corporation has paid or refunded all the rent therefor shall be deemed for the purposes of subsection (1) to be provided rent free by the employer or associated corporation;

(c) a place of residence in respect of which an employer or associated corporation has paid or refunded part of the rent therefor shall be

> deemed for the purposes of subsection (1) to be provided by the employer or associated corporation for a rent equal to the difference between the rent payable or paid by the employee and the part therefor paid or refunded by the employer or associated corporation."

6. Insofar as relevant, section 9(2) of the Ordinance deems the rental value to be 10% of the income as described in subsection (1)(a) derived from the employer, after deducting the outgoing and expenses provided for in section 12(1)(a). There was no dispute that if the taxpayer was right in his contention that the sum of $410,040.00 paid by the employer was to be considered as rental refund, then he would be liable to pay tax on the deemed rental value in the sum of $60,667.00, while if the Commissioner was right in his contention that the sum of $410,040.00 was to be treated as cash allowance, then the whole sum of $410,040.00 is taxation as income.

7. The crucial question is what is the nature of the payment of the sum of $410,040.00. This is a question of fact. The starting point is of course the contract between the taxpayer and the employer. If by the terms of the contract, the payment was to be in the nature of rental refund, then plainly due weight must be given to the contractual provisions. However in my view, although the terms of the contract are an important and weighty factor, this is not the sole factor. This is because (a) the parties may by their conducts vary the terms of the contract; or (b) even if the conducts do not amount to a variation of the terms of the contract, the parties' conducts may be such that the payment is not made in strict accordance with the terms of the contract and so the payment may be of a nature different from what is provided for in the contract.

Question 1

8. On the terms of the agreement between the taxpayer and the employer, it is clear that the benefit received by the taxpayer is described as "Housing Benefit". The term "Housing Benefit" is not limited to cases where the employee had taken up a tenancy. It could apply to cases where say, the employee has decided to buy premises to live in and the employer would give the employee money for such purposes. The sentence in clause 5.2 "The person engaged shall submit to the Consultant the evidence for the actual payment they paid for the housing" would be equally appropriate if the employee should choose to buy premises for his own use by mortgage payments. Under this clause, he would then be obliged to supply the employer the evidence of the actual down payment and mortgage payments he made.

9. Of course, the provisions in clauses 5.1 and 5.2 are equally appropriate to cover cases where the employee is to take up a tenancy for his residence, and the employer would reimburse him or would make contribution towards the rent he paid.

10. The Commissioner argued that although clause 5.2 contained the requirement that the employee is to supply to the employer evidence of the payment made by the employee, there was nothing in this clause or in any other clauses in the agreement to say

that the amount payable by the employer would have to have any relationship with the amount paid by the employee. Accordingly it was argued that on true construction of the agreement between the employer and the taxpayer, it was not necessarily the case that the money paid by the employer would be referable to the amount of rent actually paid by the taxpayer and hence the amount of $410,040.00 may or may not be a refund of rent paid.

11. I am of the view that although clause 5.2 does not expressly provide for the refund of rent or other form of payments made by the employee, it is plain that the amount payable by the employer under clause 5.2 is the maximum amount which the employer is liable to pay. This is implicit in the use of the word "cap". The word "cap" would import the notion that even if the amount required for housing by the employee is higher than the amount specified, the employer would not be liable to pay any sum in excess of the amount specified under the clause. Further, in my view, the use of the word "cap" does suggest that the amount payable by the employer could be lower than the amount specified under the clause. As to how much lower, then it would have to depend on the other provisions in this clause. In the light of the fact that clause 5.2 expressly provides that the employee would be obliged to provide the employer with the evidence of the actual payment made by him, and that under clause 3.5 the employer has the right to deduct from the salary of the employee any amount which the employer has overpaid him, in my view, it is clear from the terms of the agreement that what is envisaged in clause 5.2 is that the amount payable by the employer under this clause is the actual amount paid for the housing by the employee or the amount specified in the clause whichever is the lower. I am thus of the view that the term of the contract does envisage that the amount payable by the employer is by way of refund to the employee in respect of the amount actually paid by the employee subject to the cap.

12. However, since clauses 5.1 and 5.2 would be wide enough to cover cases where the amount actually paid by the employee is not rent, the answer to question (1) in the case stated is "No". In my view, on true construction of the terms of the agreement between the taxpayer and the employer, the intention of the parties at the time of the contract was to provide for some sort of housing benefit through the employer's refunding of the amount paid by the taxpayer for his housing subject to a cap. Such payment by the taxpayer needs not be in the nature of rent, but could be in other forms of payment, such as mortgage payment towards the acquisition of his residence.

13. However, in view of the fact the taxpayer did take up a tenancy and had actually made payment of rent, the conclusion on question 1 per se does not mean the Commissioner's appeal should be allowed.

Question 2

14. The Commissioner drew my attention to the following passage in the decision of the Board in Case No. 33/97:

> "A "refund" of rent connotes a repayment or reimbursement, not mere payment (see D19/95, IRBRD, vol. 10 157). This means in a typical case, that

> sufficient control must, as a matter of fact (and not just in theory), be exercised by the employer over the payment so that the allowance is effectively a refund of rent and not just an additional emolument to be spent in any way that an employee may desire. Where, as is apparent from this case, an employee has acted in a way such that the employer's system of control cannot operate in the manner for which it was designed (for example, by the employee's failure to submit to the employer a lease or rental receipts for verification), it ill-behooves the employee to then argue that a payment received from the employer must be a refund simply because rent was, in the event, paid by the employee. Conversely, if no system of employer control exists to verify that a payment made to an employee was a refund of rent, this is simply a cash allowance. In neither case would the payment in law amount to a rental refund for salaries tax purposes."

15. It was suggested that in order for a payment to qualify as a rental refund, a taxpayer must be able to show that his employer has a system of control exercised over the payment so as to ensure that the payment was really a refund of the rent paid by the taxpayer and not just an extra allowance paid to the taxpayer. Insofar as it is suggested that as a matter of law, the payment by an employer could never amount to a rental refund unless it is shown that the employer has a system of control in place to verify that the payment is really a refund of rent, I would disagree with such suggestion. I see no reason why the clear wordings of section 9(1A) that "where an employer or an associated corporation (ii) refunds all or part of the rent paid by the employee, such payment or refund shall be deemed not to be income" should be qualified by the additional requirement that the employer must have a particular kind of system or arrangement to control over the payment made by the employer, or to verify that the payment made is a refund of rent paid by the employee. If an employee has paid rent and under the contract of employment the employee is entitled to be reimbursed of the amount of rent he paid in whole or in part and the employer does reimburse the employee of the appropriate amount, I cannot see any reason to say that the amount paid by the employer to the employee should not be called a refund of rent in whole or in part simply because the employer has chosen not to ask the employee for any evidence of his payment or simply because the employer has not implemented any system or arrangement to make sure that what he paid is by way of refund of rent. Indeed, such system for verification is merely for his own protection to make sure that he is not being asked to pay more than what he is obliged to under the contract. If under the contract, all that the employer is obliged to do is to refund any rent paid up to a certain amount, the fact that he does not seek verification of the amount he is required to pay under the contract before he pays over the sum does not mean that what he pays is not a refund in discharge of his contractual obligation. Certainly this would not affect the right on the part of the employer to recover any overpayment if subsequently he discovers that he is paying more than he is obliged to. What I am prepared to hold is that as a matter of fact, it would generally be of great assistance to the taxpayer intending to claim the benefit of section 9(1A) to be able to show that his employer does have some sort of system to make sure that the amount paid by the employer to him is in fact in the nature of a refund of the rent paid by him, the taxpayer. In this regard, I accept the view that "refund" means "pay back (money or

expenses) or reimburse" (see Board of Review case No. D21/98).

16. My attention was also drawn to the following passages in cases before the Board:

> "One of the indicia distinguishing a rent refund from cash allowance is the control exercised by the employer over a refund ***to ensure that it cannot be spent in any way the employee wants***. This control must exist as a matter of fact and not just theory' (see Case H15 (1998) HKRC 80-523 (D33/97, IRBRD, vol. 12 228) (emphasis added).

> "On (ii), according to the Concise Oxford Dictionary, 'refund' means 'pay back (money or expenses)' or 'reimburse'. There is no allegation that the employer was in any way concerned whether the payments were actually spent by the Taxpayer on housing. There is no allegation that the ***employer exercised control over the way or ways in which the amounts paid to the Taxpayer for housing were spent***. In other words, the Taxpayer could spend as he wished and he was under no obligation to spend it on cost of housing." (Case no. D21/98) (emphasis added).

17. As I have indicated above, I agree with the notion that refund should mean "pay back" or "reimbursement". Hence unless the taxpayer had made a payment as rent, there could be no question of his receiving any refund of rent from his employer. Likewise, if the employer merely made a payment to the employee without regard or reference as to whether the employee had made any payment for rent or not, it would be difficult to see how it could be said that the payment made by the employer could amount be a refund of rent paid by the employee. However in my view, it is wrong to suggest that in order to make the payment by the employer as a refund of rent, the employer would have to exercise some control over the ways in which the amount paid to the taxpayer is to be spent. Insofar as there is anything in the 2 passages cited above suggesting to the contrary, I am of the view that such suggestion is wrong. This is because where a taxpayer has spent money to pay rent and his employer then reimburses him of the amount he paid, the money he receives from his employer would then become his own money, and he must be free to spend his money in whatever way he wants. It would be wrong to impose an obligation on the part of the taxpayer to spend the money he received from his employer in any particular way such as only for the purposes of his own housing. A "refund" of rent would connote that the person receiving the "refund" has already spent his own money to pay rent. Thus when he receives the "refund", the money he so obtains back would become his money and is not to be further burdened by any obligation as to how it could be spent.

18. On the facts of the present case, the majority of the Board found that the payment of $410,040.00 by the employer was rent refund. The majority took the view that "the real test was the nature of the payment itself and this in turn depends on the intention of the parties at the time they entered into the contract of employment". While I agree that the terms of the contract is a very useful starting point and is a very weighty

factor in deciding the nature of the payment, I think it would be wrong to say that the terms of the contract would be the sole test. Again while I agree that the intention of the parties is the real test, the relevant point of time is the time of the payment of the money by the employer and not the point of time when the parties entered into the contract of employment.

19. On the facts of the present case, the taxpayer did take up a lease and paid rent. The amount of rent he paid in fact was more than the amount of $410,040.00 he received from his employer. The housing benefit was paid to the taxpayer together with his monthly salary. Since rent was payable monthly in advance and the monthly salary was paid in arrears, there is no question that by the time when the taxpayer was paid his $34,170.00 housing benefit each month, he would have already paid his rent for the month which should be larger than the sum of $34,170.00. If matter was left here, without any further evidence of any surrounding circumstances relating to the payment other than the terms of the employment contract, there would be ample justification for a conclusion that the payment made by the employer was rent refund. In fact, it would appear to me to be the only reasonable conclusion.

20. However, there is further information about the payment. First, on the taxpayer's own admission, the arrangement between him and the employer was such that he was entitled to the same housing benefit even if he did not rent any property or rented a property at a rent lower than the amount of housing benefit stated in the appendix. This would effectively mean that he would be entitled to be paid the same sum of money even though he had not made any payment of rent himself. In such circumstances, it would be difficult to see how the housing benefit received by him could be a rental refund because the arrangement could be that there was nothing in respect to which there could be a refund. Of course, in the event of that had happened, he did take up a lease for his residence and did pay rent in advance and the rent paid was more than the amount of housing benefit he was entitled to receive. Before the Board, it was contended that in these circumstances, it would be a hypothetical question as to whether he was right in his understanding that he would be entitled to the same amount of housing benefit even if he did not in fact rent any property or even if the rent he actually paid was less than the amount of the housing benefit to which he was entitled.

21. Again had the matters ended there with no further information I would have been prepared to come to the view that the taxpayer might well have misinterpreted his rights under the employment contract. He might have thought that he was entitled to more than what was stipulated in his contract. However, there is further evidence in the present case which I cannot ignore.

22. The employer in the present case informed the Inland Revenue that:

(a) the employer's standing policy did not require employee to be accountable for the monthly allowance;

(b) housing allowance was paid as a cash allowance over which the taxpayer

was free to spend;

(c) the taxpayer was not required to produce documentary evidence to claim the allowance;

(d) the employer did not request a copy of the tenancy agreement for the year of assessment.

23. The Commissioner would contend that in the light of all these 4 features and also the fact that the taxpayer would also consider that he would be entitled to the same amount of housing benefit even though he did not rent any premises, the majority of the Board were wrong in concluding that the amount of $410,040.00 paid to the taxpayer was rental refund.

24. As I have pointed out above, I am of the view that a pertinent question to ask is whether the conducts on the parts of the employer and the taxpayer would constitute a variation of the obligations under the employment contract, or whether these conducts were such that they showed that the employer and the taxpayer had intended that the payment of $410,040.00 was paid and received on basis different from what was strictly stipulated in the contract of employment. In this respect I have come to the view that the conducts of the parties were such that they showed that they intended that the payment should be on a basis different from what was strictly stipulated in the contract of employment. For instance, clause 5.2 of the contract would enjoin the taxpayer to submit to the employer the evidence of the actual rental payment he made. However, plainly the taxpayer did not do so, and the employer had also by its conduct agreed that he needed not do so. In short, in the circumstances of this case, it would appear to me that the employer had waived its right under the contract to require the taxpayer to show him that the amount the housing benefit paid was no more than the amount of rent paid by the taxpayer for his accommodation. The taxpayer had also agreed to such altered arrangement over the question of the housing benefit because he too considered that he was entitled to be paid the maximum amount capped regardless of whether he actually spent any sum on rent at all.

25. In the circumstances, I am of the view that the majority of the Board were wrong in coming to conclusion that the amount of $410,040.00 was by way of refund of rent. The answer to Question 2 raised in the case stated is “Yes”.

26. Accordingly this appeal is allowed.

(Edward Chan)
Recorder of the Court of First Instance

Representation:

Mr Steven Parker, GC, of the Department of Justice, for the Appellant

Respondent, in person (absent)