

HCIA 9/2005

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

INLAND REVENUE APPEAL NO. 9 OF 2005

BETWEEN

YAU WAH YAU

Appellant

and

THE COMMISSIONER OF INLAND REVENUE

Respondent

Before: Deputy High Court Judge Gill in Court

Date of Hearing: 12 January 2006

Date of Judgment: 25 January 2006

J U D G M E N T

1. This is an appeal by way of case stated by a taxpayer against the decision of the Board of Review.

2. The matter arose following a determination by the Deputy Commissioner to assess for tax payments made to the taxpayer Yau Wah Yau by his employer Realink Paging Limited of the

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amounts of HK\$150,000, HK\$360,000 and HK\$840,000 during the years of assessment 1998/99 to 2000/01 inclusive. Mr Yau claimed the amounts paid and received were not taxable because they were refunds of rent paid by him to the landlord of the home he was occupying. The Deputy Commissioner decided they were taxable because they were cash allowances. On appeal the Board ruled in favour of the Deputy Commissioner. It is against this decision that Mr Yau appeals.

Background

3. In 1991 Mr Yau accepted an offer of employment put to him by a company called Realink Industries Limited in the position of its Managing Director. This included a commitment; 'to provide quarter(s) to you at the time when the Board of Directors approve'. In a reorganization undertaken in 1994 Realink Paging took over the employment contract.

4. In February 1998 a company called Rich Conquest Limited bought premises in King's Park Rise, Kowloon. Mr Yau and another called Yau Wong Ching are directors and each a 50% shareholder of Rich Conquest.

5. By letter of November 1998 Realink Paging wrote to Mr Yau in which it stated that the Board approved the premises as quarters for Mr Yau as from 1 January 1999 at HK\$50,000 per month until further notice, with a right for Realink Paging on 2 months' notice to 'terminate the quarter'. By letter signed by Rich Conquest and Mr Yau dated 23 December 1998 (the internal memo) it was agreed that Rich Conquest would charge Mr Yau HK\$50,000 a month to rent the premises as from 24 December with a right for Mr Yau on 2 months' notice to 'terminate the renting'.

6. A memorandum of lease said to have been entered into on its date of 24 December 1998 by Rich Conquest as lessor and Mr Yau as lessee of the premises in question recorded a lease to run from 24 December to 31 March 1999 at a rental of HK\$50,000 per month payable 'on or before the 2nd day of each calendar rental period during the term provided.' The lease was not stamped.

7. Realink Paging's Board resolved at a meeting of 24 December 1998 to approve the lease and reimburse Mr Yau 'the monthly rent paid by him to the landlord according to the memorandum.'

8. By debit note dated 28 December 1998 Rich Conquest claimed from Mr Yau HK\$150,000 being 'rental fee 1/1/99 to 31/3/99'. Rich Conquest issued a receipt to Mr Yau for HK\$150,000 on 1 January 1999.

9. Thereafter, by internal memo and memoranda of lease in like terms, the parties purported to commit to similar arrangements for the years beginning 1 April 1999 and 2000. Rich

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Conquest issued monthly receipts for rent paid 'by settlement of the amount due to Mr Yau from the company.'

10. For the three years in question Realink Paging filed employer's returns showing the amounts of HK\$150,000, HK360,000 and HK840,000 as rent having been paid to the 'landlord by the employee' for the premises in question.

11. This resulted in correspondence between Mr Yau and the Revenue which was to become central to the Deputy Commissioner declining to treat these payments as tax free and the Board upholding that decision. I repeat verbatim the Board's summary as recorded in the case stated:

11. In correspondence exchanged between the Appellant and the Respondent prior to the hearing before the Board, the Appellant asserted:

- (a) In a letter dated 14th August 2001 that *"No tenancy agreement was signed with [Rich Conquest], the landlord, in respect of my residence covering the periods 1.4.1999 to 31.3.2000 and 1.4.2000 and 31.3.2001. Copies of the rental receipts for the same period are enclosed for your perusal"*.
- (b) In a letter dated 9th June 2003 that *"No tenancy agreements were signed between [Rich Conquest] and me because I own 50% shareholding of [Rich Conquest]. As such, [Rich Conquest] has no risk of not signing tenancy agreement with me for cases like I do not pay rental to [Rich Conquest] promptly etc, and there is no need to obtain such documents for any court case. Alternatively, I have signed an internal document for the lease with [Rich Conquest], and [Rich Conquest] issued official receipts to me monthly."*
- (c) In a letter dated 22nd August 2003 that *"Mr Jarvis Siu, the Finance Manager of [Rich Conquest], was responsible to negotiate the tenancy with me. He verbally offered me the monthly rent of [the Subject Premises] according to the fair market rent, and we would negotiate the terms of the tenancy. Upon mutual agreement on all terms of the tenancy, a Memorandum of Lease would be signed by the Director of [Rich Conquest] (as landlord) and I (as Tenant) and Mr Siu acted as witness for the Memorandum ... In fact, [the Internal Memo] (dated 23.12.1998) only represented the preliminary intention and negotiation of the tenancy between Mr Siu and I ... The final agreed monthly rent and other terms of the tenancy for the period from 01.01.1999 to 31.03.1999 should be referred to ..."*

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Memorandum of Lease dated 24.12.1998, which was signed by the Director of [Rich Conquest] and P’.

12. In response to enquiries from the Respondent, Rich Conquest also stated in a letter dated 14th August 2001 that “*No formal tenancy agreements were signed by [the Appellant] and [Rich Conquest]. Instead, copies of the internal records agreed by both parties covering the periods are enclosed for your reference*”.

The board’s decision

12. In summary, the Board called in to question the sudden emergence in August 2003 of memoranda of lease given the earlier assertions made up to as recent a date as June 2003 that no tenancies had been signed. It took the point that in any event the memoranda not having been stamped were inadmissible, and that they bore the hallmarks of being self-serving. Otherwise, there was an absence of evidence to prove the necessary contract of landlord and tenant as between Rich Conquest and Mr Yau, a burden which at law fell on Mr Yau. It was noted that he had chosen not to appear at the hearing and give an explanation for his inconsistencies.

13. By this means it found in favour of the Deputy Commissioner having rejected Mr Yau’s arguments, and confirmed the assessments.

14. It also noted that the Deputy Commissioner had as an alternative sought to rely on section 61 of the Inland Revenue Ordinance, to the effect that the tenancy put forward by Mr Yau was artificial or fictitious. It ruled that in view of its findings it was not necessary to rule on section 61.

The appeal

15. The questions of law I am required to resolve have been stated as follows:

1. Whether the Board erred in law in holding on the facts as found by the Board that the Appellant failed to discharge his onus of proof in establishing that the sums in question were refunds of “rent” paid in respect of a tenancy which was said to subsist in fact between the Appellant and Rich Conquest?
2. In the event that the answer to the question posed by the Appellant is in the affirmative
 - (a) whether, on the facts as found by the Board

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- (i) the purported “letting” of the Subject Premises by Rich Conquest to the Appellant and/or
 - (ii) the alleged provision of quarters by Realink Paging to the Appellant by way of rent refund were “artificial or fictitious” and should be disregarded pursuant to section 61 of the Inland Revenue Ordinance?
or
- (b) whether the matter should be remitted to the Board for its determination of the issue in (a) above.

Discussion

16. The competing arguments in respect of question 1 are narrow in compass; namely, as asserted by the Commissioner, has the Board undertaken a fact finding exercise and, on the evidence evaluated, found that the taxpayer has not discharged his burden of proof; or, as asserted for Mr Yau, did the Board improperly consider or overlook the evidence available to it, and in doing so apply the wrong standard of proof, and thereby err in law?

17. Of course it is not within my proper function to impugn the Board’s evaluation of the evidence, for that would undermine the Board’s role as a fact-finding tribunal. As was said by Barnett J in *CIR v Inland Revenue Board of Review and Another*, [1989] 2 HKLR 40, at page 58:

“... the Board need only give a general indication of the evidence relied on in reaching any finding of primary fact. Assuming that the Board are able to indicate the existence of such evidence, that is the end of the matter. The court is not permitted to re-evaluate that or any other evidence to see whether it might have made a different finding.”

18. So, has the Board properly undertaken its evaluation of the evidence available to it?

19. As Mr Barlow for the taxpayer and Ms Chung for the Commissioner both accept the test to be applied is as follows: is there evidence to establish the existence of a tenancy agreement, and is there evidence that a tenancy was performed?

20. The following is incontrovertible or not challenged:

- (a) Mr Yau was entitled to the rent relief as a term of his contract of employment;
- (b) Rich Conquest owned quarters, invoiced Mr Yau for rent of those quarters and received Mr Yau for payment of those invoices;

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- (c) Mr Yau occupied those quarters;
- (d) Realink Paging at a Board meeting approved the memorandum of lease and reimbursement to Mr Yau of the rent paid by him;
- (e) Realink Paging in its employer's returns declared the payments to have been made.

21. The Board reached its findings having found Mr Yau to have been inconsistent in his responses to queries raised and rejected as inadmissible the memoranda of lease because they were not stamped. There can be no fault in that but that does not in my view entitle it to ignore the evidence that was admissible and which points to a bona fide tenancy, albeit informally entered into, and performance.

22. Furthermore, there is nothing to indicate that Rich Conquest had not filed profits tax returns to show the rent had been received, and there is nothing to suggest that Realink Paging had by its returns set out to defraud the Revenue; in other words, nothing to disturb the presumption of their having conducted themselves lawfully in each case.

23. By opting out of the incontrovertible evidence upon which no realistic finding of fact could be reached save that there was a tenancy and it was performed, I am satisfied that the Board erred in law in its findings of fact by applying the wrong standard of proof. The answer to question 1 is 'Yes'.

24. I come now to question 2.

25. The Board made no finding on whether the transactions were artificial or fictitious although it heard argument for and against the Deputy Commissioner's claim that they were and that the assessments should be confirmed on this alternative ground.

26. In my view on the evidence before it the Board could not have found the transactions to have been either fictitious, a sham, nor that they were artificial. There is nothing to be gained from returning the matter back to the Board for consideration for a second time. The answers to questions 2(a) and 2(b) are 'No'.

27. There was an application before me to amend the case stated for reasons I shall not go into. Suffice to say that I do not see the need for what amounts to a technical adjustment and make no order on the summons, with no order for costs.

28. As for the case stated, the appeal having been allowed costs are to the Appellant.

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29. Both costs' orders are *nisi*.

(D.M.B. Gill)
Deputy High Court Judge

Mr B Barlow, instructed by Messrs Robertsons, for the Appellant

Ms A Chung, Acting Principal Government Counsel, of the Department of Justice, for the Respondent