

Case No. D21/18

Property tax – owner – net assessable value – whether assignment unrealistic and artificial transaction – whether sole or dominant purpose to obtain a tax benefit – deduction of mortgage interest – sections 2, 5, 42(1), 61, 61A, 68(4) and 68(9) of IRO

Panel: Wong Kwai Huen Albert (chairman), Chan Yue Chow and Lee Tsung Wah Jonathan.

Date of hearing: 10 October 2018.

Date of decision: 19 February 2019.

The Appellant purchased Properties C during the period from May 2006 to February 2008.

Company K was incorporated in Hong Kong on 24 December 2012.

For the period from 24 December 2012 to 31 March 2016, the Appellant was the sole director and shareholder of Company K.

The Appellant entered into the Transaction (the 2012 Agreement, the 2015 Agreement and the Supplement Agreement) with Company K by which he assigned all the rights and liabilities of Properties C to Company K for ‘its use, management and subletting’.

In consideration for the assignment, the Appellant received from Company K a monthly fee of \$20,000 for the period from 1 January 2013 to 31 March 2015 and an annual fee of \$1,000 from 1 April 2015 to 31 March 2016. The rent paid by the Tenants was received by Company K.

The Appellant argued that he should be liable to Property Tax only in respect of the property income received from Company K.

The Appellant claimed that he should be allowed deduction of interest paid on various loans as mortgage loan interest under section 42(1) for the years of assessment 2013/14 to 2015/16 respectively.

Held:

1. At all material times, the Appellant remained as the legal owner of Properties C. The Transaction had not changed the Appellant’s legal

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entitlements in any way, the Appellant should be chargeable under Property Tax.

2. The Appellant failed to establish the legal position of Company K under the Transaction.
3. The Transaction could not serve the commercial purposes asserted by the Appellant. The Transaction did not shift any risk from the Appellant as long as he remained the registered owner of Properties C.
4. The Transaction is unrealistic and artificial and should be disregarded.
5. The Transaction was entered into or carried out for the sole or dominant purpose of enabling the Appellant to obtain a tax benefit.
6. There is no evidence to support the Appellant's claim that the Private Loans were borrowed for acquisition of Properties C. It follows that the Bank Loans which were alleged to be used to repay the Private Loans could not satisfy the requirements of the proviso to section 42(1) of the IRO.
7. Except for the interest paid for the Bank H Loan, all other bank loan interest incurred by the Appellant should not be allowed for deduction.

Appeal dismissed and costs order in the amount of \$20,000 imposed.

Cases referred to:

D55/01, IRBRD, vol 16, 477

D13/07, (2007-08) IRBRD, vol 22, 365

Seramco Limited Superannuation Fund Trustees v Income Tax Commissioner [1977] AC 287

Commissioner of Taxpayer Audit and Assessment v Cigarette Company of Jamaica Limited (in Voluntary liquidation) [2012]

Yick Fung Estates Ltd v Commissioner of Inland Revenue [2000] 1 HKLRD 381

Ngai Lik Electronic Co Ltd v Commissioner of Inland Revenue (2009) 12 HKCFAR 296

D27/04, IRBRD, vol 19, 219

Appellant in person.

Leung Hoi Sze, Lau Wai Sum and Lee Shun Shan, for the Commissioner of Inland Revenue.

Decision:

Background Facts

1. This is an appeal by Mr A ('the Appellant') against the determination of the Respondent dated 25 April 2018 ('the Determination') in respect of Property Tax Assessments and Additional Personal Assessments for the years of assessment 2013/14 to 2015/16 ('the Assessments').

2. The background facts of this case are rather complicated. The Board of Review ('the Board') has found the facts set out in first part of the Determination to be relevant. They are reproduced as below:

- (1) The Appellant has objected to the Assessments raised on him. He claims that the Assessments were excessive.
- (2) For the period from 1 April 2013 to 31 March 2016 ('the Period'), the Appellant was the sole owner of the following properties:

| | <u>Location</u> | <u>Date of acquisition</u> | <u>Purchase consideration</u> \$ |
|-----|-----------------|----------------------------|-------------------------------------|
| (a) | Property B | 28 Jun 1995 | 1,210,000 |
| (b) | Properties C | | |
| | '4/F Unit' | 22 May 2006 | 368,000 |
| | '6/F Units' | 4 Sep 2006 | 1,000,000 |
| | '14/F Unit' | 30 Sep 2006 | 638,000 |
| | '7/F Unit' | 30 Apr 2007 | 530,000 |
| | 'G/F Units' | 11 Oct 2007 | 1,089,000 |
| | '1/F Unit' | 22 Oct 2007 | 250,000 |
| | '3/F Units' | 18 Feb 2008 | 930,000 |

- (3) (a) (i) To finance the acquisition of Property B, the Appellant borrowed a mortgage loan from Bank D. On 22 August 1996, the Appellant refinanced the loan with Bank E. The refinanced loan was repaid in full on 17 February 1998.

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- (ii) On 31 August 2006, the Appellant borrowed a mortgage loan from Bank F using Property B as security.
 - (iii) On 2 October 2007, the Appellant borrowed a mortgage loan of \$639,711 from Bank F using Property B as security ('the Bank F Loan') to repay the loan in Fact (3)(a)(ii). The outstanding principal of the Bank F Loan of \$130,303 was repaid on 16 April 2013.
 - (iv) On 15 April 2013, the Appellant borrowed a mortgage loan of \$1,820,000 from Bank G ('the Bank G Loan') using Property B as security. The Bank G Loan was repaid in full on 15 July 2016.
- (b)
- (i) On 3 October 2007, the Appellant borrowed a mortgage loan of \$1,000,000 from Bank H using Property C 6/F Units as security ('Bank H Loan – 6/F Units'). On 28 November 2007, the parties executed a related rental assignment as additional security for Bank H Loan – 6/F Units. The outstanding principal of \$429,677 was repaid on 29 October 2013.
 - (ii) On 28 November 2007, the Appellant borrowed a mortgage loan of \$650,000 from Bank H using Property C 14/F Unit as security and executing a related rental assignment as additional security ('Bank H Loan – 14/F Unit'). The outstanding principal of \$426,803 was repaid on 29 October 2013.
 - (iii) On 18 February 2008, the Appellant borrowed a mortgage loan of \$650,000 from Bank H using 3/F Units as security ('Bank H Loan – 3/F Units'). The outstanding principal of \$433,055 was repaid on 29 October 2013.

Bank H Loan – 3/F Units, Bank H Loan – 6/F Units and Bank H Loan – 14/F Unit are collectively referred to as 'the Bank H Loans'. The Bank H Loans were repaid subsequent to Bank H's notification of termination of the Appellant's accounts.

- (c) On 28 October 2013, the Appellant borrowed a mortgage loan of \$3,720,000 from Bank J using 6/F Units as security and executing a related rental assignment as additional security ('Bank J Loan – 6/F Units').

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- (4) (a) Company K is a private company incorporated in Hong Kong in 2012. It closed its first set of accounts on 31 March 2014.
- (b) For the period from 24 December 2012 to 31 March 2016, the Appellant was the sole director and shareholder of Company K. Madam L, the Appellant's mother who was born in December 1924, was appointed as a director of Company K on 16 October 2016.
- (c) Company K's registered office was at Property B, which was also the Appellant's place of residence.
- (d) In the reports of its director, the principal activity of Company K was described as follows:

| <u>Period(s) ended 31 March</u> | <u>Principal activity</u> |
|---------------------------------|--|
| 2014 and 2015 | Properties investment for rental purpose |
| 2016 | Subletting and management of properties |

- (5) (a) On 28 December 2012, the Appellant and Company K entered into a Management and Assignment Agreement ('the 2012 Agreement') in which the Appellant assigned all his rights and liabilities of Properties C to Company K for its use, management and subletting subject to the following terms and conditions:
- (i) Company K would manage and be responsible for expenses incurred in maintaining and repairing or improving the properties, including Government rent, rates, management fee, electricity, water, repairing, legal fee, leasing expense, fire & damages, claims, third parties liability, insurance, etc.
- (ii) Company K would pay the Appellant a monthly rent of \$20,000.
- (iii) Company K had the right to use, lease, sub-let and manage the properties as well as the right to receive the rent of the properties.
- (iv) The agreement would be effective from 1 January 2013 through 31 December 2022 (i.e. for 10 years).
- (v) The above terms and conditions could be modified and improved by mutual written agreement of the Appellant and Company K.

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The Appellant signed the 2012 Agreement for and on behalf of Company K.

- (b) On 31 March 2015, the Appellant and Company K entered into another Management and Assignment Agreement ('the 2015 Agreement') with the same terms as provided in the 2012 Agreement except:
- (i) The agreement would be effective from 1 April 2015 through 31 March 2024 (i.e. for another 10 years); and
- (ii) Company K would pay the Appellant a fixed annual assignment cost of \$1,000 plus a discretion profit sharing provided that Company K had a net gross profit.

The Appellant signed the 2015 Agreement for and on behalf of Company K.

- (c) On 1 April 2015, the Appellant and Company K entered into a supplement agreement ('the Supplement Agreement') to cancel and supersede the 2015 Agreement. The Supplement Agreement provided that it was a supplement to the 2012 Agreement and that Company K agreed to pay the Appellant an annual rent of \$1,000 for the year ended 31 March 2016.

The Appellant signed the Supplement Agreement for and on behalf of Company K.

- (6) On divers dates, the Appellant or Company K in the capacity of landlord entered into the following tenancy agreements with tenants of Properties C ('the Tenants'):

- (a) Tenancy agreements entered into by the Appellant

| <u>Date of agreement</u> | <u>Location</u> | <u>Tenancy period</u> | <u>Monthly rent</u> \$ |
|--------------------------|---------------------|---------------------------|---------------------------|
| 6 Aug 2012 | Units 8 and 9, 6/F | 15 Aug 2012 – 14 Aug 2014 | 8,800 |
| 17 Oct 2012 | Room F of 7/F Unit | 24 Oct 2012 – 23 Oct 2014 | 2,500 |
| 21 Nov 2012 | 3/F Units | 1 Jan 2013 – 31 Dec 2014 | 14,250 |
| 30 Aug 2013 | Units 6 and 7, 6/F | 1 Sep 2013 – 31 Aug 2014 | 13,000 |
| 24 Feb 2014 | Units 6 and 7, 6/F | 7 Mar 2014 – 30 Apr 2016 | 15,000 |
| 5 May 2014 | Room I of 14/F Unit | 6 May 2014 – 5 May 2015 | 2,000 |
| 4 Sep 2014 | Units 8 and 9, 6/F | 5 Sep 2014 – 4 Sep 2016 | 17,000 |
| 24 Sep 2014 | 4/F Unit | 8 Oct 2014 – 7 Oct 2015 | 10,500 |
| 10 Jun 2015 | Room I of 14/F Unit | 6 Jul 2015 – 5 Jul 2017 | 2,200 |
| 4 Jul 2015 | Room C of 14/F Unit | 6 Jul 2015 – 5 Jul 2016 | 3,800 |

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- (b) Tenancy agreements signed by the Appellant for and on behalf of Company K

| <u>Date of agreement</u> | <u>Location</u> | <u>Tenancy period</u> | <u>Monthly rent</u> \$ |
|--------------------------|---------------------|---------------------------|---------------------------|
| 26 Jan 2013 | Room K of 14/F Unit | 1 Feb 2013 – 31 Jan 2014 | 1,300 |
| 30 Jan 2013 | Room D of 7/F Unit | 1 Feb 2013 – 31 Jan 2014 | 1,900 |
| 6 Feb 2013 | Room A of 14/F Unit | 7 Feb 2013 – 6 Feb 2014 | 2,000 |
| 9 Mar 2013 | Room F of 14/F Unit | 18 Mar 2013 – 17 Mar 2014 | 3,000 |
| 16 Apr 2013 | Room L of 14/F Unit | 22 Apr 2013 – 21 Apr 2014 | 1,800 |
| 2 May 2013 | Room I of 14/F Unit | 6 May 2013 – 5 May 2014 | 1,800 |
| 7 May 2013 | Room B of 14/F Unit | 13 May 2013 – 12 May 2014 | 2,800 |
| 8 May 2013 | Room J of 14/F Unit | 16 May 2013 – 15 May 2014 | 1,500 |
| 9 Jul 2013 | Room G of 14/F Unit | 18 Jul 2013 – 17 Jul 2015 | 2,900 |
| 19 May 2014 | Room L of 14/F Unit | 26 May 2014 – 25 May 2015 | 2,000 |
| 23 Jun 2014 | Room C of 14/F Unit | 1 Jul 2014 – 30 Jun 2015 | 3,500 |
| 1 Sep 2014 | 1/F Unit | 1 Sep 2014 – 31 Aug 2015 | 3,600 |
| 19 Dec 2014 | 3/F Units | 1 Jan 2015 – 31 Dec 2016 | 20,000 |
| 10 Jun 2015 | Room L of 14/F Unit | 26 Jun 2015 – 25 Jun 2016 | 2,200 |
| 1 Oct 2015 | 1/F Unit | 1 Oct 2015 – 30 Sep 2016 | 4,000 |
| 23 Nov 2015 | 4/F Unit | 24 Nov 2015 – 30 Nov 2017 | 13,000 |
| 1 Mar 2016 | Units 8 and 9, 6/F | 16 Mar 2016 – 15 Mar 2018 | 16,500 |

- (7) In his Tax Returns – Individuals for the years of assessment 2013/14 to 2015/16, the Appellant declared, among other things, the following particulars:

- (a) Gross rental income

| | <u>2013/14</u> \$ | <u>2014/15</u> \$ | <u>2015/16</u> \$ |
|--------------|----------------------|----------------------|----------------------|
| Properties C | 240,000 | 240,000 | - |
| 6/F Units | - | - | <u>1,000</u> |
| | <u>240,000</u> | <u>240,000</u> | <u>1,000</u> |

- (b) Deduction for interest payments

| | <u>2013/14</u> \$ | <u>2014/15</u> \$ | <u>2015/16</u> \$ |
|---|----------------------|----------------------|----------------------|
| <i>Interest payments to produce rental income</i> | | | |
| Bank H Loan – 3/F Units | 7,417 | - | - |
| Bank H Loan – 14/F Unit | 7,314 | - | - |

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| | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|--|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| Bank H Loan – 6/F Units and Bank J Loan – 6/F Units | <u>39,231</u> | <u>75,981</u> | <u>71,417</u> |
| | <u>53,962</u> | <u>75,981</u> | <u>71,417</u> |
| <i>Home loan interest</i> | | | |
| The Bank F Loan and the Bank G Loan | <u>35,606</u> | <u>37,076</u> | <u>35,637</u> |

The Appellant elected for Personal Assessment for the above years of assessment.

- (8) Since the borrowing for the acquisition of Property B was fully repaid in 1998 [Fact (3)(a)(i)], the Respondent opined that the interests on the Bank F Loan and the Bank G Loan were not qualified for deduction as home loan interests. Accordingly, the Respondent raised on the Appellant the following Property Tax Assessments and Personal Assessments for the years of assessment 2013/14 to 2015/16:

(a) Property Tax Assessments

| | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|--|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| Rental income [Fact (7)(a)] | 240,000 | 240,000 | 1,000 |
| <u>Less: 20% statutory allowance for repairs and outgoings</u> | <u>48,000</u> | <u>48,000</u> | <u>200</u> |
| Net Assessable Value | <u>192,000</u> | <u>192,000</u> | <u>800</u> |

No Property Tax was demanded as the Appellant had elected for Personal Assessment.

(b) Personal Assessments

| | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|---|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| Salaries income | - | 21,774 | 189,240 |
| Properties income [Fact (8)(a)] | <u>192,000</u> | <u>192,000</u> | <u>800</u> |
| Total income | 192,000 | 213,774 | 190,040 |
| <u>Less: Interest payable on properties let [Fact (7)(b)]</u> | <u>53,962</u> | <u>75,981</u> | <u>800</u> |
| Reduced total income | 138,038 | 137,793 | 189,240 |
| <u>Less: Basic allowance</u> | <u>120,000</u> | <u>120,000</u> | <u>120,000</u> |
| Net Chargeable Income ('NCI') | <u>18,038</u> | <u>17,793</u> | <u>69,240</u> |
| Tax Payable thereon | <u>90</u> | <u>88</u> | <u>711</u> |

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The Appellant did not lodge any objection against the above assessments, which became final and conclusive in terms of section 70 of the Inland Revenue Ordinance ('the IRO').

- (9) (a) Company K furnished its audited financial statements and tax computations for the periods ended 31 March 2014 to 2016 reporting the Assessable Profits or Adjusted Loss which were computed as follows:

| Period ended 31 March | <u>2014</u> | <u>2015</u> | <u>2016</u> |
|--|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| Rental income | 734,359 | 750,050 | 780,700 |
| Other Income | <u>-</u> | <u>1,200</u> | <u>-</u> |
| | <u>734,359</u> | <u>751,250</u> | <u>780,700</u> |
| <u>Less:</u> Agency commission | 17,454 | 18,755 | 27,447 |
| Auditors' remuneration | 6,500 | 5,000 | 5,200 |
| Bank charges | - | - | 700 |
| Building management fees | 105,154 | 90,132 | 90,132 |
| Business registration fee | 250 | 2,250 | 2,250 |
| Cleaning | 2,000 | 2,400 | 2,400 |
| Entertainment | 82,549 | 51,803 | 65,782 |
| Insurance | 2,818 | 2,545 | 1,817 |
| Legal and professional fee | 17,890 | 2,000 | - |
| Local travelling | 20,489 | 58,592 | 8,420 |
| Marketing and promotion | - | - | 66,069 |
| Printing and stationery | 15,616 | 23,170 | 29,820 |
| Rates and government rent | 23,258 | 40,118 | 41,785 |
| Rental expenses | 300,000 | 240,000 | 1,000 |
| Repair and maintenance | 7,161 | 318,600 | 213,720 |
| Staff medical | 9,950 | 2,995 | 4,756 |
| Staff training | 5,760 | - | - |
| Staff welfare | 5,350 | 12,474 | 30,446 |
| Sundry expenses | 11,274 | 14,209 | 5,503 |
| Telecommunication | 12,040 | 12,147 | 11,269 |
| Utilities | 27,403 | 30,989 | 25,884 |
| Travelling | - | - | 50,902 |
| Commercial building allowance – decoration of 14/F Unit | 21,516 | 21,516 | 21,516 |
| Depreciation allowances – office equipment | 36,081 | 24,376 | 14,196 |
| Prescribed fixed assets – computer | <u>24,976</u> | <u>860</u> | <u>1,888</u> |

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| Period ended 31 March | <u>2014</u> | <u>2015</u> | <u>2016</u> |
|------------------------------------|-----------------|------------------|----------------|
| | \$ | \$ | \$ |
| | <u>755,489</u> | <u>974,931</u> | <u>722,902</u> |
| Assessable Profits/(Adjusted Loss) | <u>(21,130)</u> | <u>(223,681)</u> | <u>57,798</u> |

(b) The statements of financial position of Company K showed the following particulars:

| As at 31 March | <u>2014</u> | <u>2015</u> | <u>2016</u> |
|-------------------------------|------------------|--------------------|--------------------|
| | \$ | \$ | \$ |
| <u>Non-current assets</u> | | | |
| Property, plant and equipment | <u>492,745</u> | <u>394,923</u> | <u>235,858</u> |
| <u>Current assets</u> | | | |
| Accounts receivable | - | 20,000 | 26,200 |
| Cash and cash equivalent | <u>180,938</u> | <u>256,936</u> | <u>362,675</u> |
| | <u>180,938</u> | <u>276,936</u> | <u>388,875</u> |
| <u>Current liabilities</u> | | | |
| Deposit received | (114,100) | (167,000) | (162,800) |
| Accruals | (16,011) | (7,000) | (20,620) |
| Amount due to the shareholder | <u>(647,910)</u> | <u>(953,287)</u> | <u>(1,007,948)</u> |
| | <u>(778,021)</u> | <u>(1,127,287)</u> | <u>(1,191,368)</u> |
| Net current liabilities | <u>(597,083)</u> | <u>(850,351)</u> | <u>(802,493)</u> |
| Net liabilities | <u>(104,338)</u> | <u>(455,428)</u> | <u>(566,635)</u> |
| <u>Capital and reserves</u> | | | |
| Share capital | 100 | 100 | 100 |
| Accumulated loss | <u>(104,438)</u> | <u>(455,528)</u> | <u>(566,735)</u> |
| | <u>(104,338)</u> | <u>(455,428)</u> | <u>(566,635)</u> |

(10) In response to the Respondent's enquiries about the rental income reported in his tax returns, the Appellant made, among other things, the following assertions:

- (a) On 1 January 2013, he assigned the rights of management and income together with liabilities of Properties C and their existing leases to Company K which would pay him \$20,000 per month.
- (b) On 1 April 2015, a new arrangement was reached in which Company K would pay him a fixed fee of \$1,000 and an annual profit sharing. As Company K did not make any profit

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in the year of assessment 2015/16, he only received an amount of \$1,000 for that year.

- (11) The Respondent did not accept that the Appellant's letting out of Properties C to Company K was a genuine arrangement and considered that the Appellant should be chargeable to Property Tax in respect of the rental income from the Tenants. However, the Respondent considered that the Appellant could be allowed further deduction of the interests he claimed for the year of assessment 2015/16. Thus, it raised on the Appellant the following Property Tax Assessments and Additional Personal Assessments for the years of assessment 2013/14 to 2015/16:

(a) Property Tax Assessments

| | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|--|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| Rental income | 263,613 | 813,050 | 843,700 |
| <u>Less: 20% statutory allowance for repairs and outgoings</u> | <u>52,723</u> | <u>162,610</u> | <u>168,740</u> |
| Net Assessable Value | <u>210,890</u> | <u>650,440</u> | <u>674,960</u> |

No Property Tax was demanded as the Appellant had elected for Personal Assessment.

(b) Additional Personal Assessments

| | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|---|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| Salaries income | - | 21,774 | 189,240 |
| Properties income [Fact (11)(a)] | <u>210,890</u> | <u>650,440</u> | <u>674,960</u> |
| Total income | 210,890 | 672,214 | 864,200 |
| <u>Less: Interest payable on properties let [Fact (7)(b)]</u> | <u>53,962</u> | <u>75,981</u> | <u>71,417</u> |
| Reduced total income | 156,928 | 596,233 | 792,783 |
| <u>Less: Basic allowance</u> | <u>120,000</u> | <u>120,000</u> | <u>120,000</u> |
| NCI | 36,928 | 476,233 | 672,783 |
| <u>Less: NCI previously assessed</u> | <u>18,038</u> | <u>17,793</u> | <u>69,240</u> |
| Additional NCI | <u>18,890</u> | <u>458,440</u> | <u>603,543</u> |
| Tax Payable on NCI | 184 | 48,959 | 82,373 |
| <u>Less: Tax already charged [Fact (8)(b)]</u> | <u>90</u> | <u>88</u> | <u>711</u> |
| Tax Payable on Additional NCI | <u>94</u> | <u>48,871</u> | <u>81,662</u> |

- (12) By a letter dated 26 May 2017, the Appellant objected to the above assessments claiming that:

- (a) He did not receive any of the rent from the Tenants.

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- (b) He had entered into the 2012 Agreement with Company K and would receive an annual rent from Company K for ten years starting from 1 January 2013.
 - (c) Rent from the Tenants was received by Company K, as verified by its auditor. There should not be double counting of the same income for tax purpose.
- (13) By a letter dated 1 August 2017, the Appellant made, among other things, the following contentions:
- (a) ‘My friend introduced me to invest old industrial units because their price was low due to low demand and poor economy. As I did not have enough money to purchase any, I needed to gather personal borrowings from friend and family first for initial funding starting from 22/6/2005 ... I have also mortgaged my accommodation flat [i.e. Property B] for funding on 31/8/2006. Hence, I purchased [Properties C] by personal loan from friends/family and mortgage. As the property value raised, I have mortgaged some of properties for repaying back my previous personal borrowings owing [sic] to friends/family.’
 - (b) ‘The purchase prices [of Properties C] were much below the average market price. It proved that the properties were either under a poor condition or poor location. Hence I either needed to repair them before I could let it out for rent or leave it vacant till sell them later for a higher price. However, their repair cost were [sic] a big consideration. I have spent a total of \$422,200 to repair [3/F Units, 6/F Units and 14/F Unit] so that they could be suitable for letting out.’
 - (c) ‘The current tax allowance for property could not reasonably cover the basic maintenance cost for an old property which requires more regular repairing.’
 - (d) ‘In 2012, the situation for letting or selling was still bad. I need to get a more feasible plan on how to manage the properties for a better return of my investment. In addition, I also have to think about my retirement plan which could offer me a risk free and stable income to support my living in future. As a retired person, I need to have free time to enjoy life and take care [sic] my old mother. I also need to shift the property management duties and income risk to a third party. [According to the two business plans made on 1 March 2012 at Fact (15)(c) below], Option 2 was to invest money to redecorated [sic] and subdividing [sic] some properties into

many smaller units for letting. ... It was found out that the Option 2 was more feasible as it would improve the total rental income of the properties which I could enjoy a net and risk free with similar annual income without losing my ownership. On the other hand, the property management company would have tax incentive to invest money to repair and improve the properties for higher rental income as money spent in their redecoration or repairing was tax deductible.'

- (e) 'I could not find a suitable company to do the above job. Then, I have asked an accounting firm for advice who advised me to set up a limited company to handle the above management matters.'
 - (f) 'I have checked the arrangement with your department whether it was feasible and acceptable for IRD by calling enquiry hotline three times around 15/08/2012 for clarifications. The answer was yes as long as I and the company would report the rental income of the properties respectively for tax purpose.'
 - (g) 'In fact, I have followed your staff's advice and submitted [the 2012 Agreement] to your office for Property Tax Assessment for 2013/2014. I did not hear enquiry and objection from your department till 1 April 2017.'
 - (h) 'I have very good reasons to make the said business arrangement as it is a more viable and reasonable business.'
 - (i) 'I need to keep the ownership of [Properties C] so that I can sell any of them for urgent money use during my life.'
 - (j) 'The retired person can shift all other rental risk and managing matters to an independent limited firm which can enjoy tax incentive for improving and repairing the properties so to get higher rent. The firm can pay a lower market rent to the landlord as it takes up all the management and operation risks as well as other maintenance expense including repairing.'
 - (k) 'According to Common Law's "paid to pay" principle, the owner is only liable to pay for his property income tax if he has actually received the income. In this case, I did not receive those property income as you have re-assessed.'
- (14) In response to the Respondent's enquiries, the Appellant made the following assertions:

Letting of Properties C

- (a) G/F Units were vacant throughout the years of assessment 2013/14 to 2015/16.
- (b) 1/F Unit was vacant during the year of assessment 2013/14 while 7/F Unit was vacant during the years of assessment 2014/15 and 2015/16.
- (c) 4/F Unit was vacant during the periods from May 2013 to September 2014 and from October 2015 to November 2015.

Agreements with Company K

- (d) The 2012 Agreement and the 2015 Agreement were neither stamped nor filed to the Land Registry.
- (e) The monthly rent of \$20,000 provided in the 2012 Agreement was based on a forecast of the average annual gross rental income of Properties C for the years from 2013 to 2023 if Properties C would be kept and maintained under the purchase condition.
- (f) The Appellant was advised by his accountant that it was not good for Company K kept on losing money for years. Thus, the only feasible way was to reduce the annual rent payable by Company K to him. It was mutually agreed that Company K paid him a nominal rent of \$1,000 for the year of assessment 2015/16 as Company K did not make any profit for that year.
- (g) The Appellant was the sole person for the top management of Company K. He employed Messrs Alex So & Co to handle the accounting works of Company K, estate agents for leasing and some outside contractors for repairing works.
- (h) The Appellant signed some tenancy agreements in the capacity of landlord because the estate agents used the wrong landlord's name when they prepared the agreements. As the agreements had already been signed by the tenants, the estate agents said that the tenants did not want to sign another agreement again, but they would pay the rent to Company K directly if he provided them with an authorised letter.

Interest payment

- (i) The Bank F Loan was used to finance the purchase of 14/F Unit and the Bank G Loan was used to repay the Bank F Loan

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and his personal borrowings which were used to acquire Properties C.

- (j) Bank H Loan – 6/F Units was used to purchase G/F Units and 1/F Unit.
 - (k) Bank J Loan – 6/F Units was used to repay the Bank H Loans and part of his personal borrowings from friend, which was used to acquire 4/F Unit, 6/F Units and 14/F Unit.
- (15) The Appellant provided, among other things, copies of the following documents:

Rental income

- (a) An analysis showing that the purchase prices of Properties C were below the average market prices.
- (b) A breakdown of rental income and major expenses of Properties C from the years of assessment 2009/10 to 2016/17.
- (c) Two business plans made on 1 March 2012 for which Properties C were either kept under the purchase condition or managed by an independent company.
- (d) A breakdown of the rental income of Properties C reported by Company K for the periods ended 31 March 2013 to 2016, the particulars of which are summarised as follows:

| Periods ended 31 March | <u>2013</u> | <u>2014</u> | <u>2015</u> | <u>2016</u> |
|------------------------|----------------|----------------|----------------|----------------|
| | \$ | \$ | \$ | \$ |
| G/F Units | - | - | - | - |
| 1/F Unit | - | - | 41,700 | 45,600 |
| 3/F Units | 42,750 | 171,000 | 188,250 | 240,000 |
| 4/F Unit | 6,800 | 6,800 | 63,000 | 115,000 |
| 6/F Units | 46,400 | 222,600 | 343,000 | 315,500 |
| 7/F Unit | 15,000 | 58,859 | 2,500 | - |
| 14/F Unit | <u>9,200</u> | <u>154,950</u> | <u>111,600</u> | <u>64,600</u> |
| | <u>120,150</u> | <u>614,209</u> | <u>750,050</u> | <u>780,700</u> |

Mortgage interest

- (e) An analysis of the movements of funds used for purchase, repair and improvement of Properties C showing, among other things, the following loans from the Appellant's friend and brothers:

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| <u>Loans from the Appellant's friend</u> | | | <u>Loans from the Appellant's brothers</u> | | |
|--|------------------|--|--|------------------|--|
| <u>Date</u> | <u>Amount</u> | <u>Deposited into bank account held with</u> | <u>Date</u> | <u>Amount</u> | <u>Deposited into bank account held with</u> |
| | \$ | | | \$ | |
| 22 Jun 2005 | 41,483 | Bank M | 8 Nov 2005 | 100,000 | Bank F |
| 5 Jul 2005 | 183,555 | Bank F | 9 May 2006 | 400,000 | Bank F |
| 12 Sep 2005 | 273,910 | Bank M | 16 Jun 2006 | 109,950 | Bank F |
| 6 Mar 2006 | 188,785 | Bank F | 26 Jun 2006 | 200,000 | Bank F |
| 4 Aug 2006 | 181,350 | Bank F | 18 Sep 2006 | 250,000 | Bank F |
| 1 Sep 2006 | 1,300,000 | Bank F | 18 Dec 2006 | <u>217,000</u> | Bank F |
| 1 Dec 2006 | 286,159 | Bank F | | <u>1,276,950</u> | |
| 16 Apr 2007 | <u>349,110</u> | Bank F | | | |
| | <u>2,804,352</u> | | | | |

- (f) (i) A private loan agreement (私人貸款購房協議) dated 1 May 2005 entered into between Mr N and the Appellant showing that Mr N agreed to lend an unsecured loan up to \$3,000,000 to the Appellant during the period from 1 May 2005 to 31 December 2017 at an agreed interest rate of not exceeding 2% below the prime rate per annum for purchase of properties in Hong Kong.
- (ii) A certificate of repayment (還款收據證明) dated 1 December 2016 signed by Mr N confirming that the Appellant had borrowed total amount of \$2,804,352 from him during the period from 22 June 2005 to 16 April 2007 and the Appellant repaid to him total amount of RMB 2,950,000 for settlement of the principal and interest during the period from 26 October 2012 to 10 November 2016.
- (g) (i) A private loan agreement dated 1 November 2005 entered into between Mr P and the Appellant showing that Mr P agreed to lend an unsecured loan up to \$1,000,000 to the Appellant at an agreed interest rate of not exceeding 2% below the prime rate per annum during the period from 1 November 2005 to 31 December 2018 for purchase of properties in Hong Kong.
- (ii) A certificate of repayment dated 15 October 2011 signed by Mr P confirming that the Appellant had borrowed total amount of \$976,950 from him during the period from 9 May 2006 to 18 December 2006 and he agreed to waive the interest and received total repayments of \$507,180 from the Appellant on 10 October 2011.

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- (h) (i) A private loan agreement dated 1 November 2005 entered into between Mr Q and the Appellant showing that Mr Q agreed to lend an unsecured loan up to \$300,000 to the Appellant during the period from 1 November 2005 to 31 December 2018 at an agreed rate of not exceeding 2% below the prime rate per annum for purchase of properties in Hong Kong.
 - (ii) A certificate of repayment dated 1 July 2017 signed by Mr Q confirming that the Appellant had borrowed total amount of \$300,000 from him on 8 November 2005 and 26 June 2006 and that he agreed to waive the interest and received total repayments of \$300,000 from the Appellant on 22 June 2017 and 29 June 2017.
 - (i) An extract of the Appellant's Bank M HKD savings account passbook showing transactions for the period from 22 June 2005 to 5 October 2005.
 - (j) Extracts of the Appellant's Bank F savings account passbooks showing transactions for the periods from 5 July 2005 to 25 November 2005, 8 February 2006 to 1 January 2007, 1 March 2007 to 16 April 2007 and 7 October 2011 to 13 October 2011.
 - (k) An internet banking advice of Bank F dated 25 October 2012 showing that an amount of RMB50,000 would be paid to Ms R on 26 October 2012 with handwritten notes stating that she was the wife of Mr N.
 - (l) An internet banking advice of Bank F dated 30 October 2012 showing that an amount of RMB80,000 was paid to Mr N.
 - (m) Extracts of the Appellant's savings passbook in respect of his account maintained with Bank F, Shenzhen Branch showing the transactions for the period from 8 October 2015 to 21 December 2016.
 - (n) An internet banking advice of Bank S dated 30 June 2017 showing that two sums of \$30,000 and \$270,000 were withdrawn on 22 June 2017 and 29 June 2017 respectively from a HKD savings account with number XXX-XXXXXX-XXX.
- (16) The Respondent considered that the arrangement between the Appellant and Company K under the 2012 Agreement and the 2015 Agreement was artificial or fictitious and it was entered into for the

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sole or dominant purpose of obtaining a tax benefit. The Respondent explained to the Appellant that he should be chargeable to Property Tax in respect of the rental income of Properties C received by Company K.

(17) In relation to the application of section 61A of the IRO, the Appellant contended that the sole purpose of the transaction was to create a new business which could increase the overall rental income from Properties C.

(18) The Appellant made, among other things, the following contentions:

(a) ‘You should assess whether the owner has any tax payable reduction or tax belief [sic] by comparing those years before the transaction. It is wrong and not reasonable to use those rental income of [Company K] to assess as for the Owner because the rental income has been substantially increased and created by the company’s investment on the properties by improving the properties. If there were no transaction and the investment, the rental income should remain in the same level as previous years.’

(b) ‘The transaction is normal business arrangement which [Company K] would agree to pay the owner a reasonable annual rental income and bearing all other risks.’

(c) ‘[The 2012 Agreement] was a commercial contract [sic] of assigning right and liabilities. From my business knowledge, it is legal and enforceable as a contract. I have no knowledge that it need to be stamped. I treated it as a contract instead of lease.’

(d) ‘[The 2015 Agreement] used for year 2015/2016 was cancelled and superseded by [the Supplement Agreement]. Hence, [the 2012 Agreement] was still effective and valid.’

(e) ‘The mortgage loan was used to fund the properties by repaying the personal loan. I had to get personal borrowings from relatives and close friend for funding the purchase of the properties because I could not get enough loan from the bank at that time.’

(f) ‘The purpose of deductible properties mortgages interest is a tax concession for those who get income from properties which has been mortgaged. The reasonable limited amount would be original purchased price of the properties. As far as I know, there is no provision for the Tax authority to restrict

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the way of how a taxpayer in financing the purchase of properties. It is obviously that the income is derived from the properties mortgaged. I should be able to get the respective mortgage interest deduction as the claimed loan is lower than the original purchased price. The loan money was solely used for the purchase of the properties which generates income.’

(19) The Respondent has ascertained the following information:

- (a) The Appellant was the registered payer of rates and government rent accounts in respect of Properties C for the Period.
- (b) Rates paid in respect of Properties C, after the rates concession, were as follows:

| | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|-----------|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| G/F Units | - | 1,110 | 1,274 |
| 1/F Unit | - | 1,020 | 1,170 |
| 3/F Units | - | 3,073 | 3,090 |
| 4/F Unit | - | 1,710 | 1,800 |
| 6/F Units | 1,020 | 4,787 | 5,160 |
| 7/F Unit | - | 1,980 | 2,100 |
| 14/F Unit | - | 2,670 | 2,790 |

- (c) The Appellant paid interests of \$6,840 in respect of Bank H Loan – 3/F Units for the year of assessment 2013/14.
 - (d) The tenancy agreement entered into by the Appellant on 24 September 2014 in respect of 4/F Unit provided that the Appellant had appointed Company K to collect the rent on his behalf (Clause 19). A relevant stamp certificate was attached to the tenancy agreement.
 - (e) The rental income of Company K for the year ended 31 March 2016 was exclusive of the rent under the tenancy agreement entered into by the Appellant on 4 July 2015 in respect of Room C of 14/F Unit. According to the stamped tenancy agreement, the Appellant let out Room C of 14/F Unit for a term of a year from 6 July 2015 to 5 July 2016 at a monthly rent of \$3,800 payable in advance. Thus, the rental income for year of assessment 2015/16 was \$34,200 (i.e. \$3,800 × 9 months).
- (20) (a) The Respondent maintained the views that the Appellant should be chargeable to Property Tax in respect of the rental

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income from Properties C in Fact (15)(d). Besides, the Respondent opined that the rental income of \$34,200 in respect of Room C of 14/F Unit should also be included in computing the assessable value of Properties C and that the Appellant could be allowed deduction of:

- (i) rates paid for the following properties which were let out during the years of assessment 2013/14 to 2015/16:

| | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|-----------|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| 1/F Unit | - | 1,020 | 1,170 |
| 3/F Units | - | 3,073 | 3,090 |
| 4/F Unit | - | 1,710 | 1,800 |
| 6/F Units | 1,020 | 4,787 | 5,160 |
| 14/F Unit | <u>-</u> | <u>2,670</u> | <u>2,790</u> |
| | <u>1,020</u> | <u>13,260</u> | <u>14,010</u> |

- (ii) interests of \$6,840 in respect of Bank H Loan – 3/F Units for the year of assessment 2013/14.

- (b) The Respondent considered that the Property Tax Assessments and Additional Personal Assessments for the years of assessment 2013/14 to 2015/16 should be revised as follows:

- (i) Property Tax Assessments

| | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|--|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| Rental income reported by Company K | 614,209 | 750,050 | 780,700 |
| Rent – Room C of 14/F Unit [Fact (19)(e)] | <u>-</u> | <u>-</u> | <u>34,200</u> |
| | 614,209 | 750,050 | 814,900 |
| <u>Less: Rates paid by owners [Fact (20)(a)(i)]</u> | <u>1,020</u> | <u>13,260</u> | <u>14,010</u> |
| | 613,189 | 736,790 | 800,890 |
| <u>Less: 20% statutory allowance for repairs and outgoings</u> | <u>122,638</u> | <u>147,358</u> | <u>160,178</u> |
| Net Assessable Value | <u>490,551</u> | <u>589,432</u> | <u>640,712</u> |

- (ii) Additional Personal Assessments

| | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|--|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| Salaries income | - | 21,774 | 189,240 |
| Properties income [Fact (20)(b)(i)] | <u>490,551</u> | <u>589,432</u> | <u>640,712</u> |
| Total income | 490,551 | 611,206 | 829,952 |
| <u>Less: Interest payable on properties let [Fact (20)(a)(ii)]</u> | <u>6,840</u> | <u>-</u> | <u>-</u> |
| Reduced total income | <u>483,711</u> | <u>611,206</u> | <u>829,952</u> |

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| | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|---|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| Less: Basic allowance | <u>120,000</u> | <u>120,000</u> | <u>120,000</u> |
| NCI | 363,711 | 491,206 | 709,952 |
| Less: NCI previously assessed | <u>18,038</u> | <u>17,793</u> | <u>69,240</u> |
| Additional NCI | <u>345,673</u> | <u>473,413</u> | <u>640,712</u> |
| | | | |
| Tax Payable on NCI | 39,830 | 51,505 | 88,691 |
| Less: Tax already charged [Fact (8)(b)] | <u>90</u> | <u>88</u> | <u>711</u> |
| Tax Payable on Additional NCI | <u>39,740</u> | <u>51,417</u> | <u>87,980</u> |

3. The Appellant had previously expressed to the Respondent his disagreement with the above paragraphs (4)(b), (8), (16), (19)(d) & (e) and (20)(b). The Respondent submits that no amendment to those paragraphs is required because:

- (a) Paragraph (4)(b) stated that the Appellant was the sole director and shareholder of Company K during the period from 24 December 2012 to 31 March 2016. The subsequent change in shareholding of Company K in 2017 should not be relevant to the present case.
- (b) Paragraph (8) set out the details of the original Property Tax Assessments and Personal Assessments raised on the Appellant, paragraphs (16) and (20)(b) are the Respondent's views about the case and paragraphs (19)(d) & (e) are the Respondent's observations of the terms of the tenancy agreements.

4. The Board accepts the Respondent's submissions. In any event, the Appellant has not adduced any evidence to contradict the facts stated in the Determination.

5. The Respondent further provided the Board with the following additional facts:

- (a) The breakdown of the rental income of Properties C for the years of assessment 2013/14 to 2015/16 in tabulated form below:

| | 2013/14 | | | | 2014/15 | | | | 2015/16 | | | |
|-----------|-----------------------------|----------------|---------------|----------------|-----------------------------|----------------|---------------|----------------|-----------------------------|----------------|-----------------|-------|
| | Tenancy Agreement signed by | | | Total | Tenancy Agreement signed by | | | Total | Tenancy Agreement signed by | | | Total |
| | Appellant | Company K | Unknown | | Appellant | Company K | Unknown | | Appellant | Company K | Unknown | |
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | |
| G/F Units | - | - | - | - | - | - | - | - | - | - | - | |
| 1/F Unit | - | - | - | - | - | 25,200 | 16,500 | 41,700 | - | 45,600 | 45,600 | |
| 3/F Units | 171,000 | - | - | 171,000 | 128,250 | 60,000 | - | 188,250 | - | 240,000 | 240,000 | |
| 4/F Unit | - | - | 6,800 | 6,800 | 63,000 | - | - | 63,000 | 63,000 | 52,000 | 115,000 | |
| 6/F Units | 172,600 | 50,000 | - | 222,600 | 343,000 | - | - | 343,000 | 299,000 | 16,500 | 315,500 | |
| 7/F Unit | 25,000 | 19,000 | 14,859 | 58,859 | - | - | 2,500 | 2,500 | - | - | - | |
| 14/F Unit | - | 154,950 | - | 154,950 | 22,000 | 87,800 | 1,800 | 111,600 | 60,000 | 38,800 | 98,800 | |
| | <u>368,600</u> | <u>173,950</u> | <u>71,659</u> | <u>614,209</u> | <u>556,250</u> | <u>173,000</u> | <u>20,800</u> | <u>750,050</u> | <u>422,000</u> | <u>392,900</u> | <u>814,900*</u> | |

*\$780,700 + \$34,200 = \$814,900

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- (b) The secured bank loans obtained by the Appellant and the amounts of interest incurred on the loans in tabulated form below:

| <u>Secured bank loans</u> | <u>Drawdown Date</u> | <u>Loan amount</u> | <u>Repayment date</u> | <u>Outstanding principle</u> | <u>Interest incurred</u> | | |
|--------------------------------------|----------------------|--------------------|-----------------------|------------------------------|--------------------------|----------------|----------------|
| | | | | | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
| | | \$ | | \$ | \$ | \$ | \$ |
| <u>With Property B as security</u> | | | | | | | |
| Bank F loan | 02-10-2007 | 639,711 | 16-04-2013 | 130,303 | 361 | | |
| Bank G loan | 16-04-2013 | 1,820,000 | 15-07-2016 | <i>Not available</i> | <u>35,245</u> | <u>37,076</u> | <u>35,637</u> |
| | | | | Sub-total | 35,606 | 37,076 | 35,637 |
| <u>With Properties C as security</u> | | | | | | | |
| Bank H Loan - 6/F Units | 03-10-2007 | 1,000,000 | 28-10-2013 | 429,677 | 6,925 | - | - |
| Bank H Loan - 14/F Unit | 28-11-2007 | 650,000 | 28-10-2013 | 426,803 | 6,404 | - | - |
| Bank H Loan - 3/F Units | 18-02-2008 | 650,000 | 28-10-2013 | 433,055 | 6,841 | - | - |
| Bank J Loan | 28-10-2013 | 3,720,000 | - | - | <u>33,009</u> | <u>75,981</u> | <u>71,417</u> |
| | | | | Sub-total | <u>53,179</u> | <u>75,981</u> | <u>71,417</u> |
| | | | | Total | <u>88,785</u> | <u>113,057</u> | <u>107,054</u> |

The above bank loans are collectively referred to as 'the Bank Loans'.

- (c) A summary of the borrowing and repayment of the loans from the Appellant's friend, Mr N and two brothers, Mr P and Mr Q (collectively referred to as 'the Brothers') as shown in the Appellant's fund flow statement:

| <u>Loans from Mr N</u> | | | <u>Loans from the Brothers</u> | | |
|------------------------|------------------------|----------------------|--------------------------------|------------------------|----------------------|
| <u>Date</u> | <u>Amount borrowed</u> | <u>Amount repaid</u> | <u>Date</u> | <u>Amount borrowed</u> | <u>Amount repaid</u> |
| | HKD | RMB | | HKD | HKD |
| 22-06-2005 | 41,483 | - | 08-11-2005 | 100,000 | - |
| 05-07-2005 | 183,555 | - | 09-05-2006 | 400,000 | - |
| 12-09-2005 | 273,910 | - | 16-06-2006 | 109,950 | - |
| 06-03-2006 | 188,785 | - | 26-06-2006 | 200,000 | - |
| 04-08-2006 | 181,350 | - | 18-09-2006 | 250,000 | - |
| 01-09-2006 | 1,300,000 | - | 18-12-2006 | 217,000 | - |
| 01-12-2006 | 286,159 | - | 10-10-2011 | - | 507,180 |
| 16-04-2007 | 349,110 | - | 22-06-2017 | - | 30,000 |
| 26-10-2012 | - | 50,000 | 29-06-2017 | - | <u>270,000</u> |
| 30-10-2012 | - | 80,000 | | <u>1,276,950</u> | <u>807,180</u> |
| 08-10-2015 | - | 260,000 | | | |
| 21-07-2016 | - | 100,000 | | | |
| 21-07-2016 | - | 1,350,000 | | | |

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| <u>Loans from Mr N</u> | | | <u>Loans from the Brothers</u> | | |
|------------------------|------------------------|----------------------|--------------------------------|------------------------|----------------------|
| <u>Date</u> | <u>Amount borrowed</u> | <u>Amount repaid</u> | <u>Date</u> | <u>Amount borrowed</u> | <u>Amount repaid</u> |
| 14-10-2016 | - | 110,000 | | | |
| 10-11-2016 | - | <u>1,000,000</u> | | | |
| | <u>2,804,352</u> | <u>2,950,000</u> | | | |

6. Grounds of Appeal

6.1 The Appellant's grounds of appeal are as follows:

- (a) The Appellant has assigned all the rights and liabilities of Properties C to Company K for its use, management and sub-letting. In consideration for the assignment, the Appellant received from Company K a monthly fee of \$20,000 for the period from 1 January 2013 to 31 March 2015 and an annual fee of \$1,000 from 1 April 2015 to 31 March 2016. The rent paid by the Tenants was received by Company K. Both parties referred to these arrangements as 'the Transaction' in their submissions. The Board will therefore adopt the term 'the Transaction' to include all the relevant agreements. The Appellant argued that he should be liable to Property Tax only in respect of the property income received from Company K as follows:

| Year of assessment | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|--------------------------------|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| Property income from Company K | <u>240,000</u> | <u>240,000</u> | <u>240,000</u> |

- (b) The Appellant claimed that he should be allowed deduction of interest as mortgage loan interest under section 42(1) of the IRO in the amounts of \$89,568, \$113,057 and \$107,054 for the years of assessment 2013/14 to 2015/16 respectively. From the information available in the Appellant's Tax Returns - Individuals, the breakdown is as follows:

| Year of assessment | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|-------------------------|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| Bank F Loan | 361 | - | - |
| Bank G Loan | <u>35,245</u> | <u>37,076</u> | <u>35,637</u> |
| | 35,606 | 37,076 | 35,637 |
| Bank H Loan – 6/F Units | 6,222 | - | - |
| Bank H Loan – 14/F Unit | 7,314 | - | - |
| Bank H Loan – 3/F Units | 7,417 | - | - |
| Bank J Loan | <u>33,009</u> | <u>75,981</u> | <u>71,417</u> |
| | <u>53,962</u> | <u>75,981</u> | <u>71,417</u> |

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| Year of assessment | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|--------------------|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| | <u>89,568</u> | <u>113,057</u> | <u>107,054</u> |

6.2 The Appellant also put forward the following arguments:

- (i) the Appellant did not receive any apparent tax benefit in the Transaction;
- (ii) it was only the Respondent's assumption that the Appellant being the sole shareholder of Company K had 'created' Company K in order to obtain tax benefit;
- (iii) the Respondent failed to take into account the investments in Properties C made by Company K including renovating the properties resulting in the increase of rental income; hence, Company K rather than the Appellant was entitled to the additional rental income; presumably was also liable to paying tax thereon, if any;
- (iv) the Respondent failed to take into account how the acquisition of the properties in question were financed i.e. the Loans; presumably the interest thereon should be deductible;
- (v) the Appellant had made enquiries with the Respondent and relied on his accountants on the feasibility and acceptability of the 'Transaction' to the authorities.

7. Parties' Written Submissions

- 7.1 Upon the conclusion of the hearing, the Board gave a direction that the Appellant would be provided a copy of the Respondent's written submission. The Appellant would have 21 days to send in his written submission. The Respondent reserved its right to file a reply if any new or unexpected points were raised in the Appellant's submission.
- 7.2 Two days later, the Appellant sent a letter to the Board alleging, inter alia, that the Respondent failed to allow him sufficient time to prepare his case at the hearing and to study all the materials. The Appellant requested a chance to mediate with the Respondent. The Board informed the Appellant that mediation had to be agreed between the parties. The Board had no part to play in any mediation.
- 7.3 The Appellant sent in his written submission dated 30 October 2018 just within 21 days.

7.4 On 15 November 2018, the Appellant sent to the Board another letter purporting to adduce further evidence relating to the nature of the Transaction together with supporting documents. The Respondent sent a reply to the Appellant. Thereafter, the Appellant sent in two more letters, to which the Respondent replied. The Board was also copied in some correspondence between both parties in January 2019.

7.5 The Board holds that any materials that were submitted after the hearing would not be accepted or taken into consideration in reaching its decision. In any event, the Board has not found any information contained in the correspondence after 1 November 2018 would add anything of substance to the Appellant's case.

8. The Issues

From the Appellant's grounds of appeal, the issues in the present appeal are:

- (a) Whether, by entering into the 2012 Agreement, the 2015 Agreement and the Supplement Agreement, Company K had obtained the legal capacity to grant lease in respect of Properties C as their owner or head tenant and should be chargeable to Property Tax;
- (b) Whether the arrangements to interpose Company K between the Appellant and the Tenants, i.e. the Transaction constitutes an artificial transaction and should be disregarded for the purpose of section 61 of the IRO;
- (c) Whether the Transaction was entered into or carried out for the sole or dominant purpose of enabling the Appellant to obtain a tax benefit within the meaning of section 61A of the IRO;
- (d) Whether the bank loan interest incurred by the Appellant is qualified for deduction as mortgage loan interest under section 42(1) of the IRO.

9. Burden of proof

- 9.1 The onus of proving that the assessments are excessive and incorrect is on the Appellant under section 68(4) of the IRO;
- 9.2 It is well settled that this statutory burden requires more than simply advancing a case or even providing sufficient evidence to show that the Respondent's conclusions in the Determination are merely wrong in some respect.

- 9.3 The Appellant seemed to have failed to understand the legal effect of this provision. In his submission, he kept repeating that the Respondent ‘cannot explain and prove’ or ‘did not have solid evidence to support’ its case. The law is that the Respondent has no duty to adduce any evidence to prove its case.

10.

Finding

Effectiveness of the Transaction

10.1 The relevant statutory provisions are stated below:

(a) Section 5 of the IRO:

‘(1) Property tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person being the owner of any land or buildings or land and buildings wherever situate in Hong Kong and shall be computed at the standard rate on the net assessable value of such land or buildings or land and buildings for each such year ...

(1A) In subsection (1), “net assessable value” (應評稅淨值) means the assessable value of land or buildings or land and buildings, ascertained in accordance with section 5B –

(a) ...

(b) less –

(i) where the owner agrees to pay the rates in respect of the land or buildings or land and buildings, those rates paid by him; and

(ii) an allowance for repairs and outgoings of 20% of that assessable value after deduction of any rates under subparagraph (1).’

(b) Section 5B of the IRO:

‘(2) The assessable value of land or buildings or land and buildings for each year of assessment shall be the consideration, in money or money’s worth, payable in that year to, to the order of, or for the benefit of, the

owner in respect of the right of use of that land or buildings or land and buildings.

...

(6) *In this section, “consideration” (代價) includes any consideration payable in respect of the provision of any services or benefits connected with or related to the right of use.’*

(c) The definition of ‘owner’ is expressly provided in section 2(1) of the IRO as follows:

‘In this Ordinance, unless the context otherwise requires –

...

Owner (擁有人), in respect of land or buildings or land and buildings, includes –

(a) *a person holding the land or buildings or land and buildings directly from the Government; ...’*

10.2 In this appeal, the Board is tasked with finding who the owner of Properties C during the relevant tax years was and who should be liable to pay Property Tax under sections 5 and 5B of the IRO.

10.3 Needless to say, there could only be either the Appellant or Company K who owned Properties C in the relevant tax years.

10.4 The next task for the Board is to find what constituted the ‘net assessable value’ of Properties C. It would be either the rent paid by Company K to the Appellant or the rental income from the Tenants.

10.5 (a) The Appellant purchased Properties C during the period from May 2006 to February 2008. Company K was incorporated in Hong Kong on 24 December 2012. Hence, Properties C were acquired by the Appellant long before the incorporation of Company K.

(b) The Appellant submitted that he entered into the Transaction i.e. the 2012 Agreement, the 2015 Agreement and the Supplement Agreement with Company K by which he assigned all the rights and liabilities of Properties C to Company K for ‘its use, management and subletting’. The

agreements in the Transaction were not stamped nor registered with the Land Registry.

- (c) Between 6 August 2012 and 1 March 2016, both the Appellant and Company K, in their capacity of landlord, entered into various tenancy agreements with the Tenants.
- (d) It is the Appellant's case that by the Transaction, Company K was not only a rent collecting agent. Accordingly, the Appellant should not be chargeable to Property Tax in respect of the rent derived from Properties C. The Appellant however did not elaborate what legal position Company K was in under the Transaction.
- (e) In order to succeed in the claim that the Appellant was not liable to pay Property Tax on Properties C, the Appellant must establish that Company K had the capacity to grant leases in respect of those properties as their owner or head tenant. The Respondent argued at length that none of the agreements in the Transaction constituted a lease. In any event, they could not be adduced in evidence as they were not stamped. Ironically, the Appellant also argued vehemently that 'the Transaction was not a lease' despite that the wording 'right to use and sublet' was mentioned in the agreements. Be that as it may, under the circumstances, the Board finds that there is no need for it to decide whether the Transaction involved any landlord and tenant relationship between Company K and the Appellant. The question is then what is the exact nature of the Transaction and whether Company K had the capacity to grant lease in respect of Properties C as owner.
- (f) According to the Respondent, the records of Properties C obtained from the Land Registry showed that the Appellant was the sole legal owner of Properties C at all relevant times. Clearly, Company K had not become the legal owner of Properties C. The Appellant admitted that he had kept the ownership of Properties C so that he could sell them for urgent use of money during his life time. In such case, the Transaction was not an assignment of Properties C to Company K despite the terms of 'assigning all right and liability' and 'the right to use, manage and sublet'.
- (g) Company K clearly did not have the capacity to enter into tenancy agreements in respect of Properties C on its own as the landlord. The evidence showed that the Appellant continued to sign some of the tenancy agreements with the Tenants despite the Transaction. The Board does not accept

the Appellant's assertion that he was signing on behalf of Company K and that there were 'careless and minor mistakes in the agreements' and the Tenants refused to sign any replacement agreements. There was simply no evidence to support this submission.

- (h) The Board has difficulty in understanding the Appellant's submission that 'the 2012 Agreement clearly authorized Company K to have the capacity in granting the lease.' As submitted by the Respondent, since Company K was neither the owner nor the head tenant, the only other possible capacity left for Company K to enter into tenancy agreements with the Tenants was either as a manager or an agent of the Appellant. That explained why Company K only identified itself as 'Party B' instead of the landlord or head tenant in some of the tenancy agreements. In fact, in one tenancy agreement, there was a clause which stated that Company K was the Appellant's 'rent collecting agent'. Further, in a small claim case, the claim form filed to the Small Claims Tribunal stated that Company K acted as the manager of the registered owner of Properties C. All these instances point to the fact that Company K entered into the tenancy agreements with the Tenants as the Appellant's manager or agent and, as such, Company K had not acquired any legal title to the properties.
- (i) Since at all material times, the Appellant remained as the legal owner of Properties C and the Transaction had not changed his legal entitlements in any way, the Appellant should be chargeable under Property Tax pursuant to sections 2(1) and 5(1) of the IRO. Section 5B(2) of the IRO specifies that the assessable value of buildings includes the consideration in money payable to the order of the owner in respect of the right to use of that building. In D55/01, the Board held that the taxpayer, as a registered owner, was chargeable to Property Tax despite he did not actually receive the rent. As such, the Appellant's claim that he did not receive the rent from the Tenants cannot be accepted as a reason for not charging to Property Tax.
- (j) The major issue the Appellant faced was that once he argued that the Transaction was not a lease, he needed to explain in what capacity Company K was granting leases and collecting rent from the Tenants. The purported assignment of the 'right of use of land' on its own cannot stand in law and the Appellant failed to establish the legal position of Company K under the Transaction. It should also be noted that the Transaction dealt with titles of properties, yet none of the

underlying agreements were stamped or registered with the land authorities. More importantly, the evidence showed that there had not been any genuine and effective assignment of any legal rights over Properties C.

- (k) In view of the above findings, the Board holds that the Appellant should be chargeable to Property Tax in respect of the rent derived from Properties C.

10.6 Since the Board holds that Company K was not the owner of Properties C and there was no landlord and tenant relationship between the Appellant and Company K, consequently, the Appellant would be liable to Property Tax, and that should be the end of the Appellant's appeal. However, for the sake of completeness, the Board will also consider the applicability of sections 61 and 61A of the IRO since they were both dealt with in the Determination.

11. **Applicability of Section 61**

The Relevant Statutory Provisions and Legal Principles

11.1 Section 61 of the IRO states that:

'Where an assessor is of opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the person concerned shall be assessable accordingly.'

11.2 In D13/07, (2007-08) IRBRD, vol 22, 365, it was stated that there are four stages in the application of section 61:

- (1) identification of the transaction;
- (2) consideration of whether the transaction reduces the amount of tax payable;
- (3) consideration of whether the transaction is artificial or fictitious;
- (4) disregarding of the transaction and making of an assessment accordingly.

Artificial and fictitious transaction

11.3 In Seramco Limited Superannuation Fund Trustees v Income Tax Commissioner [1977] AC 287, it was held that a fictitious

transaction is one which those who are ostensibly the parties to it never intended should be carried out.

- 11.4 In Commissioner of Taxpayer Audit and Assessment v Cigarette Company of Jamaica Limited (in Voluntary liquidation) [2012], the Privy Council held that:

‘[When considering the meaning of the word “artificial”], context is very important. ... a transaction is ‘artificial’ if it has, as compared with normal transactions of an ostensibly similar type, features that are abnormal and appear to be part of a plan. They are the sort of features of which a well-informed bystander might say, ‘This simply would not happen in the real world.’

- 11.5 It is trite law that whether a transaction which is commercially unrealistic must necessarily be regarded as being ‘artificial’ depends on the circumstances of each particular case.
- 11.6 The Appellant contends that the Transaction is ‘a real business transaction’ and the arrangement to interpose Company K between himself and the Tenants was commercially realistic. Company K had played an important role by taking up the business risk, collecting rent and carrying out substantial improvement works on Properties C so as to increase the overall rental income. Further, through the transaction, the Appellant would get ‘risk-free stable income’.
- 11.7 The Transaction for the purpose of section 61 of the IRO was identified by the Respondent as the interposition of Company K between the Appellant and the Tenants by entering into the Transaction. In this appeal, the identification of a transaction is straightforward. The more important question is whether the Transaction reduced the amount of tax payable.
- 11.8 The Board finds that the Transaction did result in reducing substantially the amount of tax payable by the Appellant as he would only be chargeable to Property Tax in respect of the rent received from Company K, which was much less than the rental income from the Tenants. On the other hand, the rental income reported by Company K would be chargeable to Profits Tax, which would allow deduction of various expenses. In fact, the profits tax computations of Company K for the years of assessment 2013/14 to 2015/16 showed the following assessable profits or adjusted loss:

| Year of assessment | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|-----------------------------------|-----------------------|-----------------------|-----------------------|
| Basis period | 24-12-2012-31-03-2014 | 01-04-2014-31-03-2015 | 01-04-2015-31-03-2016 |
| | \$ | \$ | \$ |
| Assessable profit/(adjusted loss) | <u>(21,130)</u> | <u>(223,679)</u> | <u>57,798</u> |

- 11.9 The next question is whether the Transaction is artificial or fictitious. It has been held that commercial realism is one of the considerations in deciding artificiality.
- 11.10 The Respondent submitted that since the Appellant had remained as the legal owner of Properties C, he would remain responsible for all the owner's liabilities in respect of Properties C. The Transaction would not allow the Appellant to escape from any owner's liabilities, whether statutory or contractual, in respect of Properties C.
- 11.11 Throughout the years of assessment 2013/14 to 2015/16, the Appellant was the sole shareholder and director of Company K. Company K did not employ any staff during the relevant period. Company K's only source of income was the rental from the Tenants. The notes to the financial statements of Company K clearly stated that Company K depended heavily on the continuous financial support of its shareholder and this was reflected in the increase of 'amount due to shareholders' over the years. All these point to the facts that the Appellant remained the only person who managed Properties C and financed the decoration works carried out on Properties C. Under these circumstances, it is hard to accept the Appellant's claim that the Transaction had the effect of allowing him to enjoy risk free and stable rental income from Properties C.
- 11.12 The Respondent further submitted that the Appellant had no intention to give effect to the Transaction. The Appellant had provided four different versions of the 2012 Agreement (i.e. Versions 1, 2.1, 2.2 & 3) at different times upon request by the Respondent. All four versions of the 2012 Agreement were dated 28 December 2012 but contained different terms and conditions. In reply to the Respondent's enquiries, on 18 November 2013, the Appellant still used the payment term shown in Version 1 to explain the basis of calculation of his reported rental income for the year of assessment 2012/13. The Appellant did not mention that Version 1 had been replaced by Versions 2.1 or 2.2 until the Respondent pointed out the discrepancies in its letter dated 14 June 2017. This cast doubt on whether the Appellant had intended to give effect to the 2012 Agreement.
- 11.13 The 2015 Agreement was dated 31 March 2015 and the Supplement Agreement was dated 1 April 2015. It was clearly stated in the Supplement Agreement that the 2015 Agreement had been cancelled and superseded. However, in the Appellant's letter dated 20 April 2017, he explained the reduction in his reported rental income by referring to the payment term of the 2015 Agreement rather than that in the Supplement Agreement. The Supplement Agreement was

only provided to the Revenue on 18 January 2018 after he was challenged by the Revenue on the commercial realism of the 2015 Agreement.

- 11.14 The Board accepts the Respondent's submission that the above facts demonstrated that the Transaction could not serve the commercial purposes asserted by the Appellant. It is also doubtful whether the Appellant had the intention to carry out the terms of the 2012 Agreement and the Supplement Agreement. The Appellant appeared to rely on any version of the agreements as and when it was convenient to him.
- 11.15 The Appellant repeatedly put forward the argument that the Respondent had no right to disallow the Appellant from setting up a limited company and to enter into the Transaction which carried real commercial value to the Appellant. The value was the transfer of risk, the guaranteed rental plus a percentage sharing of profit as well as allowing more free time to the Appellant to look after his old mother.
- 11.16 The Board considers that the contentions put forward by the Appellant cannot be sustained. As already mentioned above, the Transaction did not shift any risk from the Appellant as long as he remained the registered owner of Properties C. As for commercial value and business risk, it flies in the face of common sense to say that the Transaction would achieve any of the goals alleged by the Appellant given that at all material times he was the sole shareholder and director, apart from his mother, of Company K. The Transaction was entered into between him and his own company. Any business decision of Company K would be made only by him. It would not be possible to envisage a true business relationship between him and Company K by any stretch of imagination. The fact is that to all intents and purposes, Company K was the alter ego of the Appellant. The terms stated in the Transaction coupled with the modus operandi of the Appellant and Company K showed that it was ostensibly not a normal transaction that would happen in the real world.
- 11.17 The Board therefore finds that the Transaction is clearly unrealistic and artificial in the context of Section 61 of the IRO.
- 11.18 For all of the above reasons, the Board finds that section 61 of the IRO applies and the Transaction should be disregarded. That being the case, the Appellant should be chargeable to pay Property Tax on the rental income from the Tenants.

12. Applicability of Section 61A

- 12.1 As mentioned above, it is unnecessary for the Board to consider whether section 61A of the IRO also applies in this case since the Board has found against the Appellant on sections 5 and 5B and section 61 of the IRO. Again, for the sake of completeness, the Board will briefly deal with this issue.
- 12.2 Section 61A of the IRO provides that where any transaction has, or would have had but for this section, the effect of conferring a tax benefit on a person and having regard to seven specified factors, it would be concluded that the person, or one of the persons, who entered into or carried out the transaction, did so for the sole or dominant purpose of enabling the relevant person to obtain a tax benefit, an assistant commissioner shall assess the person's liability to tax as if the transaction or any part thereof had not been entered into or carried out; or in such other manner as the assistant commissioner considers appropriate to counteract the tax benefit which would otherwise be obtained.
- 12.3 It was held in Yick Fung Estates Ltd v CIR [2000] 1 HKLRD 381 that the tests in section 61A of the IRO have to be applied objectively.
- 12.4 The Board will first deal with the issue whether the Transaction had the effect of conferring a tax benefit. The term '*tax benefit*' is defined in section 61A(3) of the IRO to mean the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof.
- 12.5 The Appellant asserted that the interposition of Company K between himself and the Tenants was a normal business arrangement and he had not obtained any tax benefit from the Transaction. The Appellant further contended that the tax benefit would only arise when his taxable income was reduced after the Transaction when compared with his taxable income in the previous years.
- 12.6 The Respondent submitted that by interposing Company K between the Appellant and the Tenants, the amount of tax payable by the Appellant would be greatly reduced. The Respondent provided a comparison table below:
- (a) Without interposing Company K, all the rent paid by the Tenants in respect of Properties C would be assessable to Property Tax and payable by the Appellant. The amounts of tax payable by the Appellant under his Personal Assessment ('PA') are as follows:

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| <u>Year of assessment</u> | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|---------------------------|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| PA tax payable | <u>39,830</u> | <u>51,505</u> | <u>88,691</u> |

- (b) With Company K interposed between the Appellant and the Tenants, the Appellant would be assessed to Property Tax in respect of the rent paid by Company K only. The amounts of tax payable by the Appellant under PA and Company K would be as follows:

| <u>Year of assessment</u> | <u>2013/14</u> | <u>2014/15</u> | <u>2015/16</u> |
|---------------------------|----------------|----------------|----------------|
| | \$ | \$ | \$ |
| PA tax payable | <u>90</u> | <u>88</u> | <u>711</u> |
| Company K | <u>0</u> | <u>0</u> | <u>0</u> |

12.7 Despite the Appellant's argument that the extra rental income was the result of Company K's investment, the Board finds that the Appellant did receive a substantial tax benefit as illustrated above. The fact that Company K had made certain investment which enhanced the rental value of Properties C was neither here nor there. The Board is only concerned with the actual rental income received from the Tenants. It matters not whether the rental income derived from investment made by the Appellant or by the Appellant via Company K.

12.8 The Board will then deal with whether or not the Transaction was entered into or carried out with the sole or dominant purpose of enabling the Appellant to obtain a tax benefit. As mentioned above, it is an objective test having regard to the seven factors set out in section 61A(1) of the IRO.

- (A) The manner in which the transaction was entered into or carried out

(1) The Respondent submitted that:

- (i) On 28 December 2012, the Appellant and Company K entered into four different versions of the 2012 Agreement by which the Appellant, in the capacity of owner, purported to assign his rights (including leasing right) and liabilities of Properties C to Company K in return for a monthly rent;

- (ii) On 1 April 2015, the Appellant and Company K entered into the Supplement Agreement by which the parties agreed to cancel and superseded the 2015 Agreement entered into by them one day before and reduce the annual rent payable by Company K in respect of Properties C for the year ended 31 March 2016 from \$240,000 to \$1,000;
 - (iii) At all relevant times, the Appellant was the sole shareholder and director of Company K. All the agreements between the Appellant and Company K were signed by the Appellant both for and on behalf of himself and Company K;
 - (iv) The Appellant continued to enter into some tenancy agreements in respect of Properties C as the owner. For the tenancy agreements entered into between Company K and the Tenants, it was also the Appellant who signed the agreements.
- (2) The Appellant argued that the Respondent's 'views were subjective' and it unduly relied upon the fact that he was the sole shareholder and director of Company K. He pointed out that he had not been the sole shareholder of Company K since 2017 and he merely signed the tenancy agreements on behalf of Company K.

The Board does not accept the arguments of the Appellant and finds that the manner in which the Transaction was entered into or carried out did not suggest a genuine commercial transaction. The shareholding of Company K after 2017 has no bearing in this appeal.

(B) The form and substance of the Transaction

- (1) The Respondent submitted that:
 - (a) In Ngai Lik Electronic Co Ltd v CIR (2009) 12 HKCFAR 296, it was held that one should '*look beyond the form and at the substance of the transaction*' and that it '*overlaps with the other paragraphs as one is in each case looking at the substance and not just the form of the relevant arrangement*';

- (b) In form, by entering into the 2012 Agreement, the Appellant had purported to assign the rights and liabilities of Properties C to Company K, a separate legal entity, for its use, management and sublet in return for an agreed rent;
 - (c) In substance, it was the Appellant, as the sole shareholder and director, who managed Properties C on behalf of Company K and provided financial support to Company K for the decoration works carried out on Properties C;
 - (d) This factor points to a tax avoidance purpose because the interposition of Company K only changed the Appellant tax position in respect of Properties C. Other liabilities and obligations in respect of Properties C remained the same.
- (2) The Appellant repeated his contentions that he had the right to invest his money and Company K was a legal and feasible business. The Board can find no substance in these contentions.
- (C) The result in relation to the operation of the IRO that, but for this section, would have been achieved by the relevant transaction
- (1) The Respondent submitted that:
 - (a) In Ngai Lik, Ribeiro PJ said that the above factor *'requires the fiscal effects of the overall transaction to be assessed'*;
 - (b) Should the Transaction be left unchallenged, the Appellant would only be liable to Property Tax in respect of the rental income from Company K. Whereas Company K would have offered for assessment the rental income from the Tenants under Profits Tax and claimed deduction of various expenses. As a result, no Profits Tax was payable by Company K in respect of the rental income;
 - (c) This factor also points to a tax avoidance purpose.
 - (2) The Appellant repeated his contention that after entering into the Transaction he was paying more Property Tax

than before. However, the issue the Board is facing is who should pay Property Tax on the actual rental income derived from the letting of Properties C. The slightly higher Property Tax the Appellant became payable after his entering into the Transaction is irrelevant.

- (3) The Board finds that the Transaction did give rise to significant fiscal effect and it points towards a tax avoidance purpose.
- (D) Any change in the financial position of the Appellant that has resulted, will result, or may reasonably be expected to result, from the relevant transaction
- (1) The Respondent submitted that:
 - (a) As the Appellant was a sole shareholder and director of Company K, it may reasonably be expected that he had full control over the income and expenses of Company K. Therefore, there should not be any difference whether the rent from the Tenants was received by Company K or the Appellant;
 - (b) However, with the Transaction, the overall tax liability of the Appellant and Company K would be greatly reduced as the Appellant would only be chargeable to Property Tax on the rent from Company K. The rental income from the Tenants which was reported in Company K's accounts would not give rise to any tax payable after charging various expenses incurred by the Appellant. In this regard, the Appellant's financial position was improved to the extent of the tax savings through the Transaction;
 - (c) This factor again points to a tax avoidance purpose.
 - (2) The Appellant again put forward the same counter-argument as stated in the previous factor. The Board accepts the submission of the Respondent and finds this factor to be satisfied.
- (E) Any change in the financial position of any person who has, or has had, any connection (whether of a business, family or

other nature) with the relevant person, being a change that has resulted or may reasonably be expected to result from the relevant transaction

- (1) The Respondent submitted that:
 - (a) As far as the Tenants are concerned, there could not be any difference to them whether they paid the rent to the Appellant or to Company K;
 - (b) The Appellant was the sole shareholder and director of Company K. The overall financial position of the Appellant and Company K, looking as a whole, would be the same. The only change resulting from the Transaction was the substantial tax reduction which the Appellant now claimed.
- (2) The Board finds that there was no change to the financial position of any person as a result of the Transaction other than the financial position of the Appellant which was substantially improved to the extent of his tax savings.

(F) Whether the relevant transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length

- (1) The Respondent submitted that:
 - (a) Though the Appellant remained as a legal owner of Properties C and the one who managed and made investment into Properties C, he purported to assign his rights to the rental income from the Tenants to Company K. In return, he only received about one-third ($=\$240,000 \div \$734,359/\$750,050$) of the rental income from the Tenants from Company K for the years of assessment 2013/14 and 2014/15 and less than 0.13% ($=\$1,000 \div \$780,700$) of the rental income from the Tenants from Company K for the year of assessment 2015/16. If it was not for the fact that Company K was beneficially owned and controlled by the Appellant, it was unlikely that the Appellant would enter into such an arrangement;

- (b) Accordingly, the Transaction had created rights or obligations which would not normally be created between persons dealing with each other at arm's length. This factor points to a tax avoidance purpose.
- (2) The Appellant's only contention was again that the actual rental income received by him was higher than that before the Transaction. The Board has dealt with this point above.
- (3) The last factor in section 61A(1) of the IRO does not apply to this appeal.

12.9 Having given due regard to the six factors set out in section 61A(1), the Board finds that a reasonable person would plainly conclude that the Transaction was entered into or carried out for the sole or dominant purpose of enabling the Appellant to obtain a tax benefit. The Respondent is entitled to apply section 61A(2)(a) and disregard the Transaction and assess the Appellant as if the Transaction had not been entered into or carried out.

12.10 The Appellant's only real grievance was that he formed a limited company i.e. Company K and purported to assign all the so-called rights and liabilities in relation to the use of Properties C. Thereafter, he expected that all the rental income to be received by Company K would be subject to Profits Tax. All the future expenses including renovation and fitting out works to the properties and sundry expense items such as his personal travelling, entertainment etc. would be charged to Company K which would end up paying very little or no Profits Tax. The agreements involved in the Transaction were very make-shift and certainly poorly thought through and drafted. They were all signed by the Appellant on behalf of both parties. They gave no effect to any purported transfer of rights on Properties C. The law does not disallow anyone from setting up a corporate vehicle to operate businesses. However, the tax laws do require a taxpayer to prove that there was a real purpose for the establishment of a limited company other than merely for the purpose of obtaining a tax benefit. It is totally disingenuous for the Appellant to deny that he received no tax benefit. It is also naive on the part of the Appellant to argue that there was a real business purpose for the setting up of Company K given the background of the formation of Company K and the modus operandi of Company K's business, if there was any.

13. Deduction of mortgage interest

13.1 The Relevant Statutory Provisions and Legal Principles are stated below:

(a) Section 42(1) of the IRO provides that:

‘For the purposes of this Part the total income of an individual for any year of assessment shall be the aggregate of the following amounts-

(a) (i) *(Repealed)*

(ii) *in respect of the years of assessment commencing on or after 1 April 1983, the sum equivalent to the net assessable value as ascertained in accordance with sections 5(1A) and 5B ...*

Provided that there shall be deducted from that part of the total income arising from paragraph (a) the amount of any interest payable on any money borrowed for the purpose of producing that part of the total income where the amount of such interest has not been allowed and deducted under Part 4.’

(b) In D27/04, IRBRD, vol 19, 219, the Board held that the proviso to section 42(1) of the IRO only allowed deduction for interest payable on money borrowed for the purpose of producing the income of an individual property against the total property income of that individual property, and the ceiling for interest deduction was the lesser value of the net assessable value of the individual property and the amount of the interest payable on any money borrowed for the purpose of producing that part of the income.

13.2 The Appellant contended that he had borrowed various loans from Mr N and the Brothers (collectively referred to as ‘the Private Loans’) for acquiring Properties C. The Appellant further claimed that there was no limitation on how the loans should be borrowed under the proviso of section 42(1) of the IRO and that since Properties C were let out to generate the rental income, he should be allowed for deduction of interest paid for the Bank Loans.

13.3 It was the Appellant’s case that Mr N and the Brothers granted him the Private Loans by way of deposits into his bank accounts during the period between 22 June 2005 and 16 April 2007. To support his

claim, the Appellant provided the three Private Loans' agreements, three certificates of repayment, bank passbooks copies and a fund flow statement. However, the Respondent pointed that the bank passbooks only showed that there were deposits credited into the Appellant's bank accounts on a particular date. They could not show that the claimed deposits were in fact sourced from Mr N or the Brothers. Besides, the three Private Loans' agreements only specified the upper limit of the loans would be granted to the Appellant for purchase of properties in Hong Kong. In fact, none of the documents submitted by the Appellant showed any details of the Private Loans such as the date, amount, source and destination of the funds borrowed.

- 13.4 Further, from the Appellant's bank passbook copies, it was noted that the subject bank accounts contained numerous other deposits and withdrawals. It should also be noted that the Appellant's fund flow statements did not cover all the transactions. In the circumstances, the Respondent submitted that the Appellant had not discharged the burden of proof to show that the alleged deposits were Private Loans from Mr N or the Brothers.
- 13.5 The Appellant submitted that he could not recollect all the details of the bank transactions. He pointed out a few correlation between the Private Loans and the purchase of properties. The Board finds that these few examples are not sufficient to support his claim. There is simply no sufficient evidence to support any claim of direct correlation between the bank deposits and the Private Loans and the allegation that the deposits were used to finance the purchase of Properties C. Thus, the Appellant's claims that the Private Loans were borrowed for the purpose of producing chargeable rental income cannot be sustained.
- 13.6 It is the Appellant's case that the Bank Loans were used to repay the Private Loans. However, since the Board has found that there is no evidence to support the Appellant's claim that the Private Loans were borrowed for acquisition of Properties C, it follows that the Bank Loans which were alleged to be used to repay the Private Loans could not satisfy the requirements of the proviso to section 42(1) of the IRO. That being the case, no part of interest paid on the Bank Loans could be allowed for deduction.
- 13.7 In any event, the Board accepts the submission of the Respondent that the Bank H Loans were obtained in 2007, the Bank G Loan and Bank J Loan was obtained in 2013. Whereas the Appellant's claimed repayments shown in the fund flow statement were made in 2011 (\$507,180), 2012 (\$130,000), 2015 (\$260,000), 2016 (\$2,560,000) and 2017 (\$300,000). There was no repayment made

in 2007 or 2013. In the absence of cogent evidence, it is difficult to see how the Bank Loans obtained are correlated with the claimed repayments of the Private Loans.

13.8 In view of the above, the Board finds that except for the interest paid for the Bank H Loan – 3/F Units, all other bank loan interest incurred by the Appellant should not be allowed for deduction.

14. Conclusion

The Board finds that the Appellant has failed to discharge the onus of proving that the assessments being appealed against are excessive or incorrect. The Appeal is dismissed.

15. Pursuant to section 68(9) of the IRO, the Appellant is ordered to pay as costs of the Board in the sum of \$20,000.