Case No. D108/02

Salaries tax – home loan interest allowance – whether a question of estoppel arose on an earlier acceptance by the Commissioner that the appellant was using the property as her place of residence – definition of 'place of residence' – whether the appellant was entitled to deduct home loan interest – whether the appellant could enjoy full benefit from the home loan interest allowance – whether 'owner' under section 26E included a beneficial owner – sections 26E and 68 of the Inland Revenue Ordinance ('IRO') – onus of proving assessment excessive or incorrect on the appellant.

Panel: Ronny Wong Fook Hum SC (chairman), Ng Yin Nam and Paul Shieh Wing Tai.

Dates of hearing: 19 September and 19 November 2002.
Date of decision: 11 January 2003.

The appellant and Madam A purchased a property. By a declaration of trust, the appellant as beneficiary and Madam A as trustee acknowledged that they shall accept an assignment of the said property as tenants in common with 2/10 shares in the appellant and 8/10 shares in Madam A but that Madam A shall hold all interest in the said property upon trust for the appellant.

The appellant submitted tax returns in which she claimed to deduct the full home loan interest allowance. The Commissioner reduced the deduction to 20% of the allowance. The appellant appealed. The issues on appeal are (1) whether the Commissioner can go behind an earlier acceptance that the appellant was using the property as her place of residence during the relevant years of assessment; (2) whether the appellant did use the property as her place of residence at any time during the years of assessment so as to be entitled to deduct home loan interest; and (3) whether the appellant as a registered tenant in common to the extent of 20% but enjoys in fact full beneficial ownership pursuant to the declaration of trust can claim 100% of the home loan interest allowance under section 26E.

Held:

1. The Board is of the view that there cannot be any question of estoppel and the Board's function is to ascertain the facts and determine what the correct assessment should be. Moreover, section 68(8) of the IRO clearly permits the Board after hearing an appeal, inter alia, to increase the assessment. Section 68(4)

expressly puts the onus of proving that the assessment is excessive or incorrect on the appellant.

2. On the issue of the place of residence, assistance can be derived from section 26E itself which uses and defines the expression 'home loan interest' and there is, therefore, an implication that the concession only applies in relation to a place of residence which is used as a 'home'. That would also be consistent with one of the meanings given to the phrase in Words and Phrases, third edition which states that 'the residence of a person is by implication that person's home, where at least he or she has a sleeping apartment or shares one, although merely sleeping on the premises is not conclusive of residence'. The question is essentially one of fact and degree. The Board is of the view that the appellant did use the property as her residence.

3. The Board is of the view that the context in which the word 'owner' is used in section 26E is such that it does not include a beneficial owner for the following reasons: (1) the IRO should not be construed wider than is necessary to give effect to its intention; (2) the interests held by joint tenants and tenants in common are legal interests and applying the *ejusdem generis* principle the reference to a 'sole owner' ought to be construed consistently as meaning the sole legal owner. This is reflected in the meaning of 'home loan' in section 26E(9); (3) one cannot ignore the word 'sole' before 'owner'. If owner in section 26E includes a beneficial owner, then the full phrase would be construed as meaning a 'sole beneficial owner'. However such a construction would create the absurd situation that where there was only one beneficial owner the provisions in section 26E(2)(b)(i) and (ii) and 26E(2)(c)(i) and (ii) would not apply but would apply if there were two or more beneficial owners even though there is no mechanism for determining how much the entitlement to deduct home loan interest should be reduced to reflect the extent of a person's beneficial ownership; and (4) a restrictive construction of the word 'owner' allows section 26E to be applied with certainty whereas a broader construction so as to include beneficial owners creates uncertainty both as to the application and extent of the entitlement to deduct home loan interest (D20/01, IRBRD, vol 16, 187 and D94/01, IRBRD, vol 16, 792 considered).

Appeal dismissed.

Cases referred to:

D20/01. IRBRD, vol 16, 187
D94/01, IRBRD, vol 16, 792

Fung Chi Keung for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. By a provisional agreement dated 1 October 1996, the Appellant and Madam A purchased a flat at Housing Estate B ('the Property') for $2,028,000. By a declaration of trust of the same date ('the Declaration of Trust'), the Appellant as 'Beneficiary' and Madam A as 'Trustee' acknowledged that they shall accept an assignment of the Property as tenants in common with 2/10 shares in the Appellant and 8/10 shares in Madam A but that Madam A shall hold all interest in the Property upon trust for the Appellant. The purchase was completed on 9 November 1996 and the Property was registered as being owned by the Appellant and Madam A as 'Tenants in common as to 8/10 to the said [Madam A] and 2/10 to the said [Appellant]'.

2. The Appellant submitted tax returns for the years of assessment 1998/99, 1999/2000 and 2000/01 in which she claimed to deduct the full home loan interest allowance permitted by section 26 of the IRO.

3. By his determination dated 16 May 2002, the Commissioner reduced the deduction claimed by the Appellant to 20% of the allowance. The Commissioner found that the Appellant had '... moved to [the Property] on or around 1 July 1998' but reduced the home loan interest allowance for the years of assessment 1998/99, 1999/2000 and 2000/01 from the 100% claimed by the Appellant to 20% on the basis that the Appellant's interest in the Property as a tenant in common was only 20% [see paragraph 3(3) of the determination]. He did so because he found that '... sections 26E(2)(b)(ii) and (c)(ii) of the Ordinance clearly provided that the amount of home loan interest paid and the relevant amount specified in Schedule 3D shall be regarded as having been paid by her or reduced (as the case may be) in proportion to her share in the ownership in [the Property]'. He added that '... a similar claim was considered by the Board of Review in D20/01 (16 IRBRD 187) where the Board held that section 26E of the Ordinance did not contemplate reduction in proportion to the beneficial interests of the joint tenants'. The Commissioner therefore confirmed the assessment.

Grounds of appeal

4. The Appellant appealed against the determination on three grounds as set out in her statement of grounds of appeal.

(a) Her first ground is that the Declaration of Trust whereby the Property was held on trust for her as sole beneficial owner was not a sham having been entered into two years before the home loan interest deduction scheme was introduced

as a tax concession. We do not understand the Inland Revenue Department ('IRD') to be suggesting that the Declaration of Trust was such a transaction. It is therefore unnecessary for us to deal any further with this ground.

(b) In her second ground of appeal the Appellant contends that the IRO does not deprive beneficial owners from claiming the full entitlement to the deduction of interest on home loan.

(c) The Appellant's third ground asserts that the Board's decision in D20/01, IRBRD, vol 16, 187 referred to by the Commissioner is distinguishable because it was concerned with the position of joint tenants.

The second and third grounds relied upon by the Appellant give rise to Issue 3 referred to below.

Hearing on 19 September 2002

5. On 9 September 2002, the IRD indicated that it wished to ask the Board to increase the assessment on the basis that the Appellant had not supplied any documentary evidence to show that she had used the Property as her place of residence during the relevant years of assessment and, therefore, was not entitled to deduct any home loan interest.

6. At the hearing on 19 September 2002, the Board heard arguments on the proper construction of section 26E of the IRO. In relation to the IRD's request to increase the assessment, the Board invited:

(a) the IRD to make submissions as to whether it is open to them to seek an increase of assessment at this stage;

(b) the parties to try to reach agreement on the basic facts in relation to the Appellant's claim that she used the Property as her place of residence and to have the matter restored before this Board in the absence of agreement.

Hearing on 19 November 2002

7. The parties failed to reach agreement on whether the Appellant did use the Property as her place of residence in the relevant years of assessment.

8. The Appellant explained her position in a statutory declaration dated 16 October 2002. She was extensively cross examined on this declaration at the resumed hearing before us on 19 November 2002.

The issues

9. The appeal raises three issues:

(a) Issue 1 is whether the Commissioner can go behind an earlier acceptance that the Appellant was using the Property as her place of residence during the relevant years of assessment.

(b) Issue 2 is whether on the evidence the Appellant did use the Property as her place of residence at any time during the years of assessment so as to be entitled to deduct home loan interest.

(c) Issue 3 is whether the Appellant as a registered tenant in common to the extent of 20% but enjoys in fact full beneficial ownership pursuant to the Declaration of Trust can claim 100% of the home loan interest allowance under section 26E.

Issue 1

10. On 25 September 2002, the IRD sent its submissions to the Appellant. It appears from the Appellant's response that she accepts:

(a) that the Commissioner is entitled to put new facts before this Board;

(b) that the Board can increase the assessment on the evidence; and

(c) that the onus of proving that the assessment is excessive or incorrect is on her.

11. Given this stance of the Appellant, it is strictly unnecessary to consider Issue 1 any further. However, for the sake of completeness, we are of the view that the consensus between the parties is correct. We do not think that there can be any question of issue estoppel and the Board's function is to ascertain the facts and determine what the correct assessment should be. Moreover, section 68(8) of the IRO clearly permits the Board after hearing an appeal, inter alia, to increase the assessment. Section 68(4) expressly puts the onus of proving that the assessment is excessive or incorrect on the Appellant.

Issue 2

12. In support of its position that the Appellant did not live in the Property the IRD relies on three pieces of evidence:

(a) First, that electricity and gas consumption at the Property was low.

(b) Second, that the Appellant had been included in an application dated 2 March 1997 for a resident's card in respect of a property at Address C ('Property 1') which was purchased in the name of a company controlled by Mr D. Mr D was then the boy friend of the Appellant. They subsequently married each other on 18 February 2001. Madam A is the mother of Mr D.

(c) Third, the Appellant's statements in respect of the mortgage over the Property was sent by Bank E to Property 1.

13. According to the Appellant's statutory declaration dated 16 October 2002 and her sworn testimony before us:

(a) She purchased the Property by a provisional agreement dated 1 October 1996. The acquisition included various pieces of furniture and fixtures in the Property.

(b) She let the Property out as a furnished flat after completing her purchase on 9 November 1996. Her first tenant left at the end of April 1997.

(c) In about June or July 1997, she let the Property to a second tenant for a fixed term of one year. She herself was then residing with her parents at a flat at Housing Estate F ('Property 2'). Property 2 is about 421 square feet (gross). It has two rooms. The Appellant shared one of the two rooms with her younger sister.

(d) Upon vacation of the Property by her second tenant, the Appellant moved into the Property with her parents and her younger sister so that renovation works could be undertaken in Property 2. Her three relatives moved back to Property 2 in about July 1998. She herself remained in the Property. Her living conditions improved given the number of occupants in Property 2. She also kept in the Property all her personal belongings.

(e) She spent three months wholly away from her parents but had difficulties coping with her household chores on top of her work. She began to spend more time in Property 2. 'I would have my evening meal there, help my mother with the dishes, take a bath afterwards, watch TV with my family, and go back to my place only when it was time for me to go to bed'. The Property is about three blocks away from Property 2. She would go straight to bed upon her return to the Property.

(f) In October or November 1999, a friend from Beijing stayed with her in the Property for about a week. Three other friends from China also stayed for a week or so in August or September 2000.

(g) She sold the Property because of the decline of the property market. The Property was renovated prior to its sale in early November 2000.

(h) She explained that she applied for a resident's card for Property 1 because four cards were given to each unit in that complex and she would like to use the shuttle bus provided by that complex.

(i) She sought clarifications from the electricity company as to the nil consumption depicted in the statements furnished in respect of the Property. She was told that the practice of that company is to record only the number of full units shown.

14. The Appellant is an honest and impressive witness. We accept her evidence in full. We reject the insinuations of the IRD that the Appellant might be residing in Property 1 or Property 2. The Appellant appears to us to be a very frugal lady with simple tastes. The low consumption of gas and electricity is consistent with the bland life which she adopts.

15. The principal challenge of the IRD on this issue hinges on the factual question whether the Appellant did use the Property. No submission was made on the question whether on the totality of the Appellant's evidence she did use the Property as her place of residence. In this regard only limited assistance is derived from the IRO which defines 'place of residence' in section 26E(9) as being, in relation to a person who has more than one place of residence, his 'principal residence'. However, the statutory definition does not answer the question as to what use must a person make of a dwelling house for that use to properly be described as his place of residence.

16. Assistance can be derived from section 26E itself which uses and defines the expression 'home loan interest' and there is, therefore, an implication that the concession only applies in relation to a place of residence which is used as a 'home'. That would also be consistent with one of the meanings given to the phrase in Words and Phrases, third edition which states that 'the residence of a person is by implication that person's home, where at least he or she has a sleeping apartment or shares one, although merely sleeping on the premises is not conclusive of residence'. The question is essentially one of fact and degree.

17. We are of the view that the Appellant did use the Property as her residence. We have borne in mind her evidence that she ate, had her clothes laundered and watched television in Property 2. She also used that flat as her correspondence address. However, she kept all her personal belongings in the Property. She spent substantial amount of time each day in the Property.

There is no evidence to suggest that any living space was reserved for her in Property 2 after July 1998. We are satisfied that the Appellant did use the Property as her residence.

Issue 3

18. The question is whether on a proper construction of section 26E the Appellant as the sole beneficial owner of the Property pursuant to the Declaration of Trust is entitled to deduct all the interest she has paid subject to the statutory maximum.

19. 'Owner' is defined by section 2 of the IRO to mean *'... in respect of land or buildings or land and buildings includes a person holding directly from the Government, a beneficial owner, a tenant for life, a mortgagor, a mortgagee in possession'*. This definition applics except where the context otherwise requires.

20. No other definition of 'owner' is given in section 26E and the IRD's stance has been that because the Property is held by the Appellant and Madam A as tenants in common, it is held by a person otherwise than as a sole owner such that the amount of interest the Appellant is entitled to deduct under section 26E(2)(a) should be regarded as having been paid or reduced by the amounts specified in section 26E(2)(b) or (c) respectively. The Appellant's argument is that the definition of 'owner' includes a beneficial owner; that under the Declaration of Trust she is the sole beneficial owner; and, therefore, section 26E(2)(b) and/or (c), which only applies where a dwelling is held <u>otherwise</u> than as a sole owner, is not applicable.

21. The issue can, therefore, be redefined as being whether the reference to 'sole owner' in section 26E(2)(b) and (c) includes a sole beneficial owner or whether the context in which the expression 'sole owner' is used in those subsections precludes that meaning. If the reference to a sole owner in section 26E(2)(b) or (c) includes a sole beneficial owner then the reduction of the amount of home loan interest that a person can deduct under section 26E(2)(a) does not arise.

22. The definition of 'owner' in section 2 of the IRO as including a beneficial owner is not preclusive. The word can have a different meaning where the context requires. We are of the view that the context in which the word 'owner' is used in section 26E is such that it does not include a beneficial owner for the following reasons:

(a) Firstly, the IRO should not be construed wider than is necessary to give effect to its intention.

(b) Secondly, the interests held by joint tenants and tenants in common are legal interests and applying the *ejusdem generis* principle the reference to a 'sole owner' ought to be construed consistently as meaning the sole <u>legal</u> owner. This is reflected in the meaning of 'home loan' in section 26E(9) where it is defined as a loan of money which is applied wholly or partly for the acquisition

of a dwelling which is held by '... the person as a sole owner, or as a joint tenant or tenant in common'.

(c) Thirdly, one cannot ignore the word 'sole' before 'owner'. If owner in section 26E includes a beneficial owner, then the full phrase would be construed as meaning a 'sole beneficial owner'. However, such a construction would create the absurd situation that where there was only one beneficial owner the provisions in section 26E(2)(b)(i) and (ii) and 26E(2)(c)(i) and (ii) would not apply but would apply if there were two or more beneficial owners even though there is no mechanism for determining how much the entitlement to deduct home loan interest should be reduced to reflect the extent of a person's beneficial ownership.

(d) Fourthly, a restrictive construction of the word 'owner' allows section 26E to be applied with certainty whereas a broader construction so as to include beneficial owners creates uncertainty both as to the application and extent of the entitlement to deduct home loan interest.

23. In D20/01 and D94/01, IRBRD, vol 16, 792 the Board has held that the reduction of the entitlement to deduct home loan interest is calculated in proportion to the number of joint tenants and not in proportion to the beneficial interests of the joint tenants. Notwithstanding that the Appellant contends that these decisions are not applicable, the construction of section 26E outlined above is consistent with the conclusion in those cases that the position of co-owners is determined by their legal interest and that on its proper construction 'owner' in section 26E does not include beneficial owner.

24. For these reasons, we decide Issue 3 in favour of the Revenue.

Conclusion

25. We are of the view that the Appellant is not entitled to deduct more than 20% of the interest she has paid in each year of assessment to reflect her 20% legal interest as a tenant in common.

26. We dismiss the Appellant's appeal.

27. The Appellant informed us that she was assisted throughout by Mr G in the preparation of her appeal. We wish to record our appreciation for the written submissions prepared by Mr G which helped considerably in clarifying the issues.