

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D123/01

**Salaries tax** – whether certain amounts of a loan fall within ‘home loan’ definition of section 26E of the Inland Revenue Ordinance (‘IRO’) – ‘home loan interest’ concession – the meaning of the word ‘acquisition’ under section 26E(9) of the IRO – sections 26E and 68(4) of the IRO.

Panel: Patrick Fung Pak Tung SC (chairman), Andy Lam Siu Wing and Ng Yin Nam.

Date of hearing: 18 October 2001.

Date of decision: 17 December 2001.

This was an appeal against the salaries tax assessment raised on the taxpayer for the year of assessment 1999/2000. The taxpayer and his wife had purchased a property (‘the Property’) in 1990 as their residence. Between 1990 and 1999, with the Property as security, the taxpayer and his wife had obtained four loans with three banks. The Inland Revenue Department accepted that some of the loans were applied for the acquisition of the Property as dwelling and thus deduction of home loan interest was allowed while some loans were not. The only issue in this appeal was whether part of the second loan was a ‘home loan’ within the meaning of section 26E of the IRO and thus entitled the taxpayer and his wife to claim the ‘home loan interest’ concession in relation thereto.

#### **Held:**

1. The Board did not agree with the taxpayer’s submission that the word ‘acquisition’ in the definition of ‘home loan’ under section 26E(9) of the IRO carried a wide meaning.
2. The Board was of the view that the word ‘acquisition’ carried its ordinary meaning. The ‘acquisition of a dwelling’ by a person is complete as soon as he completes the purchase from the vendor and pays the full purchase price, notwithstanding that the whole or part of such purchase price has been borrowed from a bank on mortgage on the security of the property in question. In ordinary parlance, one would not say that one had not completely purchased a property simply because the same had been mortgaged to a bank.
3. Strictly speaking, when a person substitutes an original mortgage of his home by a subsequent mortgage, in order to obtain a more favourable rate of interest or for

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some other reason, the Commissioner may not be obliged under the definition of 'home loan' to continue granting that person the benefit of the 'home loan interest' deduction. Nevertheless, as a matter of policy and practice, he still grants it as a concession.

4. The position of a person obtaining an additional loan by a further charge in the property, which was his dwelling, was different. In order to qualify for the concession, he had to prove that the additional loan was 'applied wholly or partly for the acquisition of a dwelling'.
5. By virtue of section 68(4) of the IRO, the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant. The Board was of the view that the taxpayer has failed to provide evidence or satisfactory evidence to prove that that part of the second loan was applied wholly or partly for the acquisition of a dwelling or for paying off a mortgage originally created to enable the acquisition by him of a dwelling.
6. Further, the Board did not think the question of the reasonableness of the taxpayer's claim arose at all because, for that question to arise under section 26E(3)(a) of the IRO, it has first to be proved by the taxpayer that he did pay 'home loan interest' as defined under section 26E(9) of the IRO. The taxpayer had failed to so prove.

### **Appeal dismissed.**

Chow Chee Leung for the Commissioner of Inland Revenue.  
Taxpayer in person.

### **Decision:**

1. This is an appeal by the Appellant ('the Taxpayer') against a notice of assessment and demand for salaries tax for the year of assessment 1999/2000 issued by the Respondent ('the Commissioner') on 26 September 2000 and subsequently revised on 25 May 2001 ('the Assessment'). An objection was lodged by the Taxpayer against the original assessment on 3 October 2000. By his letter dated 25 May 2001, the Commissioner made a determination and rejected the Taxpayer's objection and further increased slightly the net chargeable income and the tax payable thereon. The Taxpayer has brought this appeal against such determination.

### **The facts**

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2. On 14 September 1990, a property known as 'Address A' ('the Property') was assigned to the Taxpayer and his wife, Madam B as joint tenants at a consideration of \$2,062,000. They used the Property as their residence.
3. On 14 September 1990, with the Property as security, the Taxpayer and Madam B obtained from Bank C a loan of \$1,855,000 ('the First Loan'). The First Loan was repayable by monthly instalments of \$17,200 each.
4. On 4 December 1995, the Taxpayer raised a further loan of \$1,200,000 ('the Second Loan') from Bank C secured by a further charge over the Property. The Second Loan was repayable by 144 monthly instalments of \$14,900 each.
5. As at December 1995, the balance outstanding on the First Loan was \$1,299,941.
6. On 4 February 1997, the outstanding balances on the First Loan of \$1,187,711 and the Second Loan of \$1,138,210 were fully repaid to Bank C.
7. On the same date, the Taxpayer, with the Property as security, borrowed from Bank D a loan of \$2,600,000 ('the Third Loan'). The money from the Third Loan was apparently used to repay the First and Second Loans. The Third Loan was repayable by 115 monthly instalments of \$33,475 each.
8. On 2 October 1999, the outstanding balance of the Third Loan in the sum of \$2,159,321 was fully repaid.
9. On the same date, the Taxpayer and Madam B, with the Property as security, borrowed from Bank E a loan of \$2,130,000 ('the Fourth Loan'). The money from the Fourth Loan was apparently used to repay the Third Loan. The Fourth Loan was repayable by 78 monthly instalments of \$35,637 each.
10. In our recital in relation to the four loans and mortgages above, the figures of outstanding balances may not be totally accurate because of the timing. It is also not clear from the papers as to whether in some instances the Taxpayer (and not Madam B) was the sole borrower and mortgagor, although one would expect that normally Madam B would also have been a borrower and mortgagor. For present purposes, however, such points are not important because they are not in issue in this appeal.
11. In his tax return for the year of assessment 1999/2000, the Taxpayer declared that his employment income was \$998,860. The Taxpayer claimed deduction of home loan interest in respect of the Property. He declared that:

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- (a) He and Madam B paid total interest of approximately \$167,000 during the year ended 31 March 2000.
- (b) He was nominated by Madam B to claim deduction of home loan interest paid by her during the year.

12. The assessor raised on the Taxpayer the following salaries tax assessment for the year of assessment 1999/2000:

	\$	\$
Assessable income		998,860
<u>Less: Home loan interest</u>		
- The Taxpayer	39,054	
- Madam B	<u>39,054</u>	<u>78,108</u>
		920,752
<u>Less: Married person's allowance</u>	216,000	
Child allowances	<u>60,000</u>	<u>276,000</u>
Net chargeable income		<u>644,752</u>
Tax payable		<u><u>99,107</u></u>

13. The Taxpayer objected against the said assessment on the ground that he should be allowed deduction of home loan interest up to the statutory limit of \$100,000.

14. The assessor considered that interest deductible in the year of assessment 1999/2000 should be \$77,342 based on the following:

- (a) The First Loan was accepted as a loan applied for the acquisition of the Property as dwelling.
- (b) The Second Loan was not applied for the acquisition of the Property as dwelling.
- (c) Only that portion of the Third Loan which was used to pay off the unpaid balance of the First Loan, that is, \$1,181,711, was accepted as applied for the acquisition of the dwelling. On this basis, 45.451% ( $100\% \times 1,181,711 \div 2,600,000$ ) of the interest paid on the Third Loan was deductible.
- (d) The Fourth Loan was less than the outstanding balance of the Third Loan as at 2 October 1999. The whole of the Fourth Loan was regarded as having been used to pay off the Third Loan. On this basis, 45.451% of interest paid under the Fourth Loan should also be regarded as home loan interest.

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- (e) The amount of deductible interest for the year of assessment 1999/2000 should be computed as follows:

Interest paid on the Third Loan and the Fourth Loan	×	<u>Unpaid balance of the First Loan</u> The amount of the Third Loan
\$170,167	×	45.451%
= <u>\$77,342</u>		

15. Despite objection by the Taxpayer, the assessor maintained the view that the Second Loan was not a home loan and that the salaries tax assessment for the year of assessment 1999/2000 should be revised as follows:

	\$	\$
Income previously assessed		998,860
<u>Less: Home loan interest</u>		
- The Taxpayer	38,671	
- Madam B	<u>38,671</u>	<u>77,342</u>
		921,518
<u>Less: Allowances previously granted</u>		<u>276,000</u>
Net chargeable income		<u>645,518</u>
Tax payable		<u>99,238</u>

16. This led to the formal objection by the Taxpayer to the Assessment, the determination of the Commissioner and the present appeal.

**The issue**

17. The granting of a concessionary deduction to individuals for interest paid on mortgages obtained to finance the acquisition of their homes was announced in the 1998-99 Budget. It resulted in the enactment of, inter alia, section 26E of the IRO.

18. The relevant parts of section 26E of the IRO read as follows:

‘ **26E. Home loan interest**

- (1) *Subject to the other provisions of this section and to section 26F, where a person pays during any year of assessment any home loan interest for the purposes of a home loan obtained in respect of a dwelling which is used at any time in that year of assessment by the person exclusively or partly as*

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*his place of residence, a deduction in respect of the home loan interest shall be allowable to that person for that year of assessment.*

(2) (a) *Subject to paragraphs (b) and (c) and subsection (3), a deduction allowable to a person under subsection (1) in respect of any home loan interest paid by the person during any year of assessment shall be –*

(i) (A) *where the dwelling is used by the person exclusively as his place of residence during the whole of that year of assessment, the amount of the home loan interest paid; or*

(B) *in any other case, such amount (whether representing the full amount of the home loan interest paid or any part thereof) as is reasonable in the circumstances of the case; or*

(ii) *the amount specified in Schedule 3D in relation to that year of assessment,*

*whichever is of the lesser amount.*

(b) *For the purposes of this section, where a dwelling is held by a person otherwise than as a sole owner, the amount of the home loan interest paid referred to in paragraph (a)(i) shall be regarded as having been paid –*

(i) *where the dwelling is held by the person as a joint tenant, by the joint tenants each in proportion to the number of the joint tenants; or*

(ii) *where the dwelling is held by the person as a tenant in common, by the tenants in common each in proportion to his or her share in the ownership in the dwelling.*

...

(3) (a) *Where any home loan interest is paid by a person during any year of assessment for the purposes of a home loan obtained in respect of a dwelling which is used at any time in that year of assessment by that person exclusively or partly as his place of residence, but the loan was not applied wholly for the acquisition of the dwelling, the deduction*

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*allowable to the person under subsection (1) for that year of assessment in respect of the home loan interest paid shall be such part of the amount of the home loan interest paid as is reasonable in the circumstances of the case.*

...

(9) *In this section –*

*“dwelling” (住宅) means any building or any part of a building –*

- (a) which is designed and constructed for use exclusively or partly for residential purposes; and*
- (b) the rateable value of which is separately estimated under section 10 of the Rating Ordinance (Cap. 116);*

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

- (a) applied wholly or partly for the acquisition of a dwelling which –*
  - (i) during any period of time in that year of assessment is held by the person as a sole owner, or as a joint tenant or tenant in common; and*
  - (ii) during that period of time is used by the person exclusively or partly as his place of residence; and*
- (b) secured during that period of time by a mortgage or charge over that dwelling or any other property in Hong Kong;*

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

- (a) the Government;*
- (b) a financial institution;*

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- (c) *a credit union registered under the Credit Unions Ordinance (Cap. 119);*
  - (d) *a money lender licensed under the Money Lenders Ordinance (Cap. 163);*
  - (e) *the Hong Kong Housing Society;*
  - (f) *an employer of the person; or*
  - (g) *any recognized organization or association;*
- ...'

19. The Taxpayer accepts that not the entirety of the money obtained from the Second Loan, that is, \$1,200,000, was used to re-finance the acquisition of the Property. Part of the Second Loan was used for other purposes such as his children's education. He only claims the benefit of 'home loan interest' in relation to \$612,000 out of the Second Loan.

20. It is common ground between the Taxpayer and the Commissioner that the only issue in this appeal is whether that part of the Second Loan which amounted to \$612,000 was a 'home loan' within the meaning of section 26E of the IRO and thus entitles the Taxpayer (and Madam B) to claim the 'home loan interest' concession in relation thereto.

21. As we understand the Taxpayer's argument, it can be summarised as follows:

- (a) He knew in advance that the home purchase allowance to which he was entitled when he purchased the Property would come to an end by June 1996.
- (b) Taking that predictable event and the fact that he would be or was granted a promotion and increase in salary into account, it was part of his plan that he would obtain a second loan in addition to the First Loan in order to enable him to service the monthly instalments payable under the First Loan.
- (c) In the end, he obtained the Second Loan partly in fulfilment of his plan referred to in (b) above and partly to obtain finance for his children's education.
- (d) He estimated that out of the sum of \$1,200,000 borrowed under the Second Loan, a sum of \$612,000 should be attributed to his purpose of servicing the First Loan which was originally obtained to enable him to purchase the Property.



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- (e) Such planning on his part was part and parcel of the process of his acquisition of a dwelling because the word 'acquisition' in the definition of 'home loan' in section 26E(9) of the IRO should be given a wide meaning. The 'acquisition' of a dwelling by a person is not complete unless and until that person has cleared off all mortgages on the dwelling and obtained a clear and unincumbered title thereto.
- (f) In any event, his claim for concession is 'reasonable in the circumstances of the case' as specified under section 26E(3)(a) of the IRO.

### Conclusion

22. We are impressed by the fact that the Taxpayer presented his case in a brilliant and most persuasive manner. His argument both oral and in writing exhibited much ingenuity on his part. Nevertheless, having considered his argument carefully, we regret that we have come to the conclusion that he cannot succeed in this appeal.

23. To begin with, we do not agree with the Taxpayer's submission that the word 'acquisition' in the definition of 'home loan' under section 26E(9) of the IRO carries a wide meaning. We think it carries its ordinary meaning. We think that the 'acquisition of a dwelling' by a person is complete as soon as he completes the purchase from the vendor and pays the full purchase price, notwithstanding that the whole or part of such purchase price has been borrowed from a bank on mortgage on the security of the property in question. It is true that what normally happens in the majority of cases is that the purchaser of a property will finance his purchase by obtaining a loan from the bank by mortgaging the same property with the completion of the purchase and the creation of the mortgage occurring simultaneously. On the other hand, there is nothing unusual in a case where a person purchases a property as a dwelling entirely with his own funds but subsequently decides to mortgage the same property to obtain finance. In such a case, the 'loan of money' would **not** have been 'applied wholly or partly for the acquisition of a dwelling' within the definition of 'home loan' aforesaid. In any event, in ordinary parlance, one would not say that one had not completely purchased a property simply because the same had been mortgaged to a bank.

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

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

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26. Furthermore, on an appeal such as the present, by virtue of section 68(4) of the IRO:

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

27. We are of the view that the Taxpayer has failed to provide evidence or satisfactory evidence to prove that that part of the Second Loan amounting to \$612,000 was applied wholly or partly for the acquisition of a dwelling or for paying off a mortgage originally created to enable the acquisition by him of a dwelling. In cross-examination, the Taxpayer said that there was no document to indicate how the \$612,000 was used by him. It was merely an estimate by him. He said, ‘So, it is circumstantial’.

28. Furthermore, we do not think the question of the reasonableness of the Taxpayer’s claim arises at all because, for that question to arise under section 26E(3)(a) of the IRO, it has first to be proved by the Taxpayer that he did pay ‘home loan interest’ as defined under section 26E(9) of the IRO. The Taxpayer has failed to so prove.

29. In all the circumstances, we are of the view that the Taxpayer has failed to prove that either he is entitled to the concession claimed or that the Commissioner is wrong in the Assessment.

30. Accordingly, the appeal of the Taxpayer is dismissed.