Case No. D140/00

Salaries tax – whether certain amounts in dispute are rent, which is deductible as opposed to salary, which is taxable in full – retrospectively alter the nature of the income accrued by, and paid to, the taxpayer is never allowed – whether ' prevented' from giving the requisite notice of appeal – sections 8(1), 9(1)(a), 66(1) and 66(1A) of the Inland Revenue Ordinance (' IRO').

Panel: Andrew Halkyard (chairman), Ng Yook Man and Alexander Woo Chung Ho.

Date of hearing: 5 December 2000.
Date of decision: 8 March 2001.

This was an appeal, out of time, against the salaries tax assessments raised on the taxpayer for the two years of assessment 1996/97 and 1997/98. The taxpayer claimed that certain amounts paid to him by his employer as a housing benefit should not be subject to salaries tax.

Held:

1. The jurisdiction of the Board to extend time was governed by section 66(1A) of the IRO.

2. The intent of section 66(1A) was to allow a taxpayer one clear month to consider his options regarding a possible appeal and to formulate his grounds of appeal, if an appeal was desired.

3. In the present case, the Board was prepared to extend the one month appeal period prescribed by section 66(1) by virtue of the taxpayer' s absence from Hong Kong during that one month period, as it was only fair and just that the taxpayer should be given the full statutory one month period to decide whether, and on what grounds, to contest the Commissioner' s determination.

4. What the employer had tried to do was to implement fringe benefits tax planning for its employees with hindsight after the end of each year of assessment.

5. The Board knew of no authority that allowed the taxpayer and the employer for taxation purposes to retrospectively alter the nature of the income accrued by, and paid to, the taxpayer in the form of a base salary to a reduced salary plus rent. Such

a change could only take place prospectively. This was sufficient for the Board to dismiss this appeal.

6. The so-called tenancy agreements entered into between the taxpayer and his employer were ' artificial' : Seramco Ltd Superannuation Fund Trustees v ITC [1976] 2 WLR 986 at 994 applied.

7. As a result, the amounts in dispute were not rent, but salary, that were taxable in full under sections 8(1) and 9(1)(a) of the IRO.

Obiter:

1. Given the reply of the Commissioner that, provided the benefit is properly implemented and any anti-avoidance provision does not apply, the Inland Revenue Department (' IRD') would accept the efficacy of an employer providing a lessor/employee with a tax advantaged housing benefit for property owned by that employee personally. As such, the Board would only comment that it stretches the imagination to the limit to conclude that the housing benefit provisions contained in the IRO were enacted to allow an owner to take advantage of provisions which seem intended to ameliorate the comparatively high cost of rent in Hong Kong. This conclusion is reinforced by the recent enactment of a concessionary deduction for owner-occupiers to deduct from their taxable income an amount of their mortgage interest expenses.

2. Good taxation administration ensures that taxpayers in substantively the same circumstances should be treated equally.

Appeal dismissed.

Case referred to:

Seramco Ltd Superannuation Fund Trustees v ITC [1976] 2 WLR 986

Chan Tak Hong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal against the salaries tax assessments raised on the Taxpayer for the years of assessment 1996/97 and 1997/98. The Taxpayer claims that certain amounts paid to him by his employer as a housing benefit should not be subject to salaries tax.

Preliminary matter – acceptance of late notice of appeal

2. The Commissioner' s determination (see fact 16 below) was dated 27 June 2000. It was delivered to the Taxpayer' s address on 28 June 2000. The Board of Review received the Taxpayer' s notice of appeal on 29 July 2000. The appeal was thus lodged outside the one month appeal period prescribed by section 66(1). The Taxpayer was, however, absent from Hong Kong from 26 to 29 June and from 9 to 15 July 2000.

3. In our view the intent of section 66(1) is to allow a taxpayer one clear month to consider his options regarding a possible appeal and to formulate his grounds of appeal, if an appeal is desired. For present purposes, it is sufficient to note that the Taxpayer' s absence from Hong Kong during June 2000 means that he would not obtain the statutory protection of the one month period unless we extended the period under section 66(1A).

4. On the facts before us, we are prepared to extend the period on the basis that the Taxpayer was prevented from lodging a timely appeal by virtue of his absence from Hong Kong in June 2000. In our view it is only fair and just that the Taxpayer be given the full statutory period to decide whether, and on what grounds, to contest the Commissioner' s determination. We therefore allow the late notice of appeal.

The facts

5. On the basis of the documents produced, and the Taxpayer' s sworn evidence before us, which we accept, we find the following facts.

1. On 16 May 1994, the Taxpayer accepted an offer of employment with Company A as a technical consultant. The offer of employment did not explicitly refer to any provision of housing benefit. However, the company did provide its employees with a ' tax effective remuneration program' for ' housing refund' , provided ' they are still on the active payroll on April 1 of the following Hong Kong fiscal year. This program provides tax benefits for up to certain percentage of their total base compensation.' The Taxpayer was aware of this program when he joined the company.

2. In February 1996, Company A was reorganised and the Taxpayer became an employee of Company B (' the Employer'). The terms and conditions of the Taxpayer' s employment remained unchanged.

3. On 4 September 1996, the Taxpayer purchased a flat in District C (' the Residence'). The Taxpayer financed the purchase mainly by way of a long-term mortgage loan. At this time the Taxpayer decided that he wanted to take advantage of the Employer' s housing program.

4. As stated at fact 1, the Employer operated a tax effective remuneration program for housing refund for its employees. On 2 April 1997, the Employer issued an internal memorandum to all eligible staff concerning the claim for housing benefit for the year of assessment 1996/97. Under this program, eligible staff could claim housing benefit by declaring up to 40% of their total base compensation as housing benefit. In respect of housing benefit for home owners, the program stated:

> ' ELIGIBILITY
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> Full-time permanent employees in salary grade 4 and above are entitled to participate for the "Claim for Housing Benefit". The date for joining this "Housing Benefit" is April 1, 1996 or the employee' s hire date, whichever is appropriate.
>
> …
>
> HOUSING BENEFIT FOR HOME OWNERS: TENANCY AGREEMENT
>
> For an employee who owns and occupies his/her residence, [the Employer] is prepared to enter into a tenancy agreement with him/her at fair market rental with the sole purpose of providing the property back to the employee for personal residence.
>
> If employees wish to take advantage of the arrangement for the fiscal year 1996/97, they must execute the tenancy agreement and return a stamped copy of the agreement to [the Employer] **before April 15, 1997**.' (emphasis in original)

5. Pursuant to this internal memorandum, on 9 April 1997 the Taxpayer submitted a claim for housing benefit for home owners for the year of assessment 1996/97. This claim, that designated the Residence as the accommodation for which housing benefit was sought, stated that the monthly rent was $14,000, the monthly management fee was $813 and the monthly rates were $337. The total claimed by the Taxpayer in the form he

submitted to the Employer only included the purported rent component for the period from 4 September 1996 to 31 March 1997 of $97,066.[1]

6. By a tenancy agreement dated 25 March 1997[2] and stamped on 15 April 1997 (' the First Tenancy Agreement'), the Taxpayer purportedly let the Residence to the Employer from 4 September 1996 to 31 March 1997 at a monthly rent of $14,000. Under the agreement the rent was to be paid on the last day of each month and the first of such payments was to be made on 4 September 1996. The agreement provided that the Taxpayer was to pay the Crown rent, property tax, rates, maintenance and management charges and utility charges for the Residence.

7. On 20 June 1997, the Employer issued an internal memorandum in relation to the claim for housing benefit for the year of assessment 1997/98. Certain changes were made in the procedures for making claims. The most important changes were (a) enrolment in the program was stated to be ' at the beginning of respective taxable year' (previously, the enrolment was ' at the end of respective taxable year') and (b) the tenancy agreement should be stamped ' within 30 days of execution and at the beginning of respective taxable year' (previously, stamping was ' at the end of respective taxable year').

8. Pursuant to this internal memorandum, on 24 June 1997 the Taxpayer submitted a claim for housing benefit for home owners for the year of assessment 1997/98. This claim, that designated the Residence as the accommodation for which housing benefit was sought, stated that the monthly rent was $14,000, the monthly management fee was $813 and the monthly rates were $402. The total claimed by the Taxpayer in the form comprised all these components for the period from 1 April 1997 to 31 March 1998 of $182,580.[3]

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[1] The claim was subsequently amended to include amounts for management fee ($5,700) and rates ($2,020) giving a total claim of $104,786. The Employer's human resources department made these amendments. The Taxpayer was not aware of the amendments until after they were made. Under cross-examination he could not adequately explain how these additional figures were arrived at. The Taxpayer also agreed that under the tenancy agreement (fact 6 refers) he was liable, as landlord, for water charges in respect of the Residence but that the Employer also reimbursed the relevant amount to him and that this figure may have been included in the amount for management fee.

[2] The Taxpayer agreed that the tenancy agreement was made in response to the internal memorandum dated 2 April 1997 (fact 4 refers). He could not explain why the agreement was dated 25 March 1997 and agreed that it should have been dated after 2 April 1997. He agreed that the date appearing on the agreement was ' unreal' . The Taxpayer reiterated, however, that at this time he had already entered into an oral agreement to lease the Residence to the Employer (fact 13(c) refers).

[3] As was the case for the year of assessment 1996/97 (footnote 2 refers) this claim was subsequently amended, presumably again by the Employer's human resources department, so that the amount for which rental claimed to be received was reduced from $182,580 to $172,832. The Taxpayer admitted that the amendment would have

9. By a tenancy agreement dated 20 June 1997[4] and stamped on 7 July 1997 ('the Second Tenancy Agreement'), the Taxpayer purportedly let the Residence to the Employer from 1 April 1997 to 31 March 1998 at a monthly rent of $14,000. Under the agreement the rent was to be paid on the last day of each month and the first of such payments was to be made on 1 April 1997. The other terms of the agreement were identical to those of the First Tenancy Agreement.

10. The Taxpayer's monthly payroll slips disclosed basic salary, bonus, allowance and other income items (total $471,051 for the year of assessment 1996/97 and $576,166 for the year of assessment 1997/98). These various income components represented the Taxpayer's total remuneration entitlements under his contract of employment. They did not specifically refer to any amount for housing benefit although for the year of assessment 1997/98 a monthly aggregate entry entitled 'basic salary/housing' was included. In the year of assessment 1996/97 the entry was simply entitled 'basic salary'.

11. In his tax returns for the years of assessment under appeal, the Taxpayer did not report the total income items referred to at fact 10. Instead, he reduced those items by certain amounts including $104,786 (for the year of assessment 1996/97) and $172,832 (for the year of assessment 1997/98) and claimed those latter amounts represented rent paid to him (as landlord) by the Employer for the provision of the Residence.

12. The Taxpayer supplied to the assessor copies of rental receipts for the Residence issued by him to the Employer for the period from 4 September 1996 to 31 March 1998. All the receipts were dated the first day of the month. The amount shown in the receipt for September 1996 was $12,600 and for the other months was $14,000.

13. In correspondence with the assessor the Taxpayer stated that:

    (a) From September 1996 to March 1998 only he and his wife resided in the Residence.

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been made at the end of April 1998 when the Employer was checking the claim for housing benefit. No explanation was given for this reduction but the Taxpayer agreed that this reduced amount is exactly equal to 40% of his base compensation of $432,080, and the reduced amount is the maximum that he could have claimed under the Employer's housing benefit program. In substance, the difference between the total claim of $172,832 and the purported rent of $168,000 ($14,000 x 12) = $4,832 is simply a balancing figure.

[4] As with the previous tenancy agreement (footnote 2 refers) the Taxpayer agreed that the date appearing on the agreement was 'unreal'.

(b) He collected the keys to the Residence on 3 September 1996, but he physically took possession on 7 September 1996. After decoration work, he moved in to the Residence on 19 October 1996.

(c) The housing benefit was included as part of his compensation (see fact 4) and he was aware of the Employer' s intention to rent the Residence by 4 September 1996. The tenancy agreement was concluded orally on that day.[5]

(d) No written tenancy agreement was executed immediately at the time when the oral agreement was concluded. For administrative reasons the Employer wanted to handle all employees eligible for housing benefits at the same time, namely, at the end of the fiscal year.

(e) The First Tenancy Agreement was a formality between the parties to confirm the oral agreement and to make it legally enforceable.

(f) The housing benefit provided by the Employer included rent, rates and management fees as follows:

	Year of assessment 1996/97	**Year of assessment 1997/98**
	$	$
Rent	96,600	168,000
Rates	2,356	4,832
Management fee	5,830	0
	104,786	172,832

14. In response to the assessor' s enquiries the Employer stated:

(a) Its policy was to enter into tenancy agreements with employees at fair market rent. Therefore no negotiation for rent was necessary. The policy was well understood by both parties prior to the commencement of the tenancy. The tenancy agreement was merely to document this mutual understanding.

[5] In evidence the Taxpayer explained the 'oral agreement' by saying that it was his understanding that, at some point in time, he could enter into the Employer's housing program described at fact 4 and that if he joined the program he would have to follow its terms.

(b) The Taxpayer had supplied to it a stamped tenancy agreement, receipts for rental, management fees and rates when he submitted his claim under its housing benefit program.

(c) The Taxpayer's monthly base compensation comprised the base salary and rent. The rent was paid to the Taxpayer in one lump sum together with his base salary and the total amount was shown as base salary/housing in his payroll slip.[6]

(d) The computations for the Taxpayer's annual bonus and the contributions to the staff provident fund[7] were based on his monthly base compensation.

15. The assessor took the view that the purported rent paid by the Employer to the Taxpayer per fact 11 represented a cash allowance and should be taxed in full.

16. The Commissioner, in her determination dated 27 June 2000, upheld the assessor's view, concluding that no genuine landlord and tenant relationship was entered into between the Taxpayer and the Employer and that the purported letting of the Residence was artificial.

17. By a notice of appeal dated 26 July 2000, the Taxpayer lodged an appeal against the Commissioner's determination to this Board of Review. The Board received the notice on 29 July 2000.

The Taxpayer's contentions

6. The Taxpayer claims that the housing benefit should not be fully taxed because the benefit was provided to him by the Employer as part of his compensation package and that he followed the correct procedures set out by the Employer in claiming the housing benefits to which he was entitled. The Taxpayer also does not understand why some of his colleagues in a similar position have had their claims accepted by the IRD, while his claim was not accepted.

Decision and reasons therefor

[6] This was for the year of assessment 1997/98 only; in the year of assessment 1996/97 the total amount was simply entered as 'basic salary'.

[7] In its application for approval of a retirement scheme signed in November 1986, the Employer stated that its contribution to the scheme was '5% of basic salary'. The Taxpayer could not respond to a question as to why the purported housing benefit was included in the 5% contribution made by the Employer if it were not in reality salary.

7. On the basis of the facts found, it is not necessary to analyse in detail the competing arguments of the parties. The reason for this is that the Employer has simply failed in its endeavour to provide the Taxpayer with a so-called tax effective remuneration package' for housing refund. The reason why it has failed is that after the end of each year of assessment, and after the Taxpayer has been paid a monthly basic salary, the Employer has attempted to implement its remuneration package with the benefit of hindsight (see particularly, footnotes 1 to 4 and related facts). As the Taxpayer admitted in cross-examination, he could not answer how his remuneration package would have been any different if he was not on the Employer' s payroll on 1 April of the following fiscal year. Specifically, he agreed that if his employment ended on 1 January (so that he was not on active payroll on 1 April and thus could not participate in the housing program) then no housing benefit (namely, rent) could have been paid to him. He also agreed that if his employment ended on 1 January then the Employer would make no change to the monthly basic salary (or basic salary/housing for the year of assessment 1997/98) previously paid to him. And yet, notwithstanding all this, the Taxpayer and the Employer claim that they had entered into a valid tenancy agreement before the end of the fiscal year and that rent was paid to the Taxpayer by the Employer for each relevant month of that year. Plainly this is a nonsense.

8. In short, what the Employer has tried to do is to implement fringe benefits tax planning for its employees with hindsight after the end of each year of assessment. We know of no authority, and none was given to us, that allows the Taxpayer and the Employer for taxation purposes to retrospectively alter the nature of the income accrued by, and paid to, the Taxpayer in the form of a base salary to a reduced salary plus rent. Such a change could, in our view, only take place prospectively. This is sufficient for us to dismiss this appeal.

9. If necessary, we would go further and conclude that, on the basis of the Commissioner' s arguments before us, the so-called tenancy agreements entered into between the Taxpayer and the Employer were ' artificial' (as that term has been interpreted by the Privy Council in Seramco Ltd Superannuation Fund Trustees v ITC [1976] 2 WLR 986 at 994).

10. In the result the amounts in dispute of $104,786 and $172,832 are not rent, but salary, that are taxable in full under sections 8(1) and 9(1)(a) of the IRO. The appeal is hereby dismissed.

11. Before concluding, we wish to make two final points. During argument we asked the Commissioner' s representative whether, conceptually, the IRD accepted the efficacy of an employer providing a lessor/employee with a tax advantaged housing benefit for property owned by that employee personally. The representative replied that, provided the benefit is properly implemented and any anti-avoidance provision does not apply, the IRD would accept this state of affairs. We would only comment that it stretches the imagination to the limit to conclude that the housing benefit provisions contained in the IRO were enacted to allow an owner to take advantage of provisions which seem intended to ameliorate the comparatively high cost of rent in Hong Kong.

This conclusion is reinforced by the recent enactment of a concessionary deduction for owner-occupiers to deduct from their taxable income an amount of their mortgage interest expenses.

12. Finally, it became clear during the hearing before us that the Taxpayer felt aggrieved that he was not being allowed a tax benefit when some of his fellow workers in a similar position were obtaining the benefit. It is not for us to comment on the position of taxpayers whose affairs are not before us. But we would comment that good taxation administration ensures that taxpayers in substantively the same circumstances should be treated equally. The Commissioner may wish to consider this matter.