

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D149/00

Salaries tax – housing benefits – whether should be classified as a refund of rent or an allowance – section 9(1)(a) and 9(1A)(a) of the Inland Revenue Ordinance (‘IRO’).

Panel: Andrew Halkyard (chairman), Edward Chow Kam Wah and Douglas C Oxley.

Dates of hearing: 5 and 11 December 2000.

Date of decision: 27 March 2001.

The taxpayer appealed against the salaries tax assessments for the years of assessment 1995/96, 1996/97 and 1997/98. The taxpayer claimed that certain amounts paid to him by his employer as a housing benefit should be classified as a refund of rent and should not be considered as an allowance wholly subject to salaries tax.

Hence the issue before the Board of Review was whether the sums paid by the taxpayer by Company A of \$304,000 (for the year of assessment 1995/96) and by Company D of \$456,000 (for each of the years of assessment 1996/97 and 1997/98) were cash allowances taxable under section 9(1)(a) of the IRO or refunds of rent within section 9(1A)(a).

Held:

1. The ordinary meaning of ‘refund’ connotes a repayment or reimbursement, not mere payment. There must be actual payment of rent in the first place before a subsequent reimbursement by the employer could constitute a refund of rent (see D8/82, IRBRD, vol 2, 8; D19/95, IRBRD, vol 10, 157 and D92/95, IRBRD, vol 11, 173).
2. One of the indicia distinguishing a rent refund from cash allowance is the control exercised by the employer over a refund to ensure that it cannot be spent in any way the employee wants. This control must exist as a matter of fact and not just in theory (see D33/97, IRBRD, vol 12, 228). The question whether a housing allowance is a rent refund or a cash allowance also depends on the parties’ intention at the time they enter into the contract of employment (see D18/99, IRBRD, vol 14, 204).
3. The Board decided to consider this appeal in relation to two distinct periods (1) from August to October 1995 (when the taxpayer lived in the District K property)

INLAND REVENUE BOARD OF REVIEW DECISIONS

and (2) from November 1995 to March 1998 (when he lived in the Property). As for the latter period, the Board found that the monthly sum of \$38,000 paid to the taxpayer by the relevant employer was a refund of rent on the following grounds:

- (a) a housing benefit of \$38,000 per month was agreed to be provided to the taxpayer in his contract of employment;
- (b) under that contract, the parties intended to provide a housing benefit for the taxpayer up to a maximum amount of \$38,000 per month in the form of a refund of rent where employer accommodation was not available to the taxpayer;
- (c) the taxpayer had entered into a valid tenancy agreement with Company F under which he paid a monthly rent to Company F of \$38,000 for use of the Property;
- (d) a copy of that lease was given to Company A; and
- (e) the taxpayer obtained rental receipts from Company F for each month and these were then passed to Ms G who at all material times was responsible for the payroll of Company A and later, Company D.

The Board found that sufficient control was exercised by the employer to ensure that the monthly payment of \$38,000 was a refund of rent and not simply a cash allowance that the taxpayer could spend as he wished.

4. From the period from August 1995 to October 1995, the Board found that the taxpayer did not incur rent for occupation of this property on the following grounds:
- (a) no lease was produced in evidence;
 - (b) no rent for the period August to September 1995 was recorded in the profit and loss account of Company F; and
 - (c) unlike the subsequent period, the oral evidence was not as compelling or as clear in the admittedly hectic period between the sale of shares in Company A until the taxpayer moved to the Property.

It followed that the payments of \$38,000 per month made to the taxpayer for this earlier period were properly subject to salaries tax.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Appeal allowed in part.

Cases referred to:

- D8/82, IRBRD, vol 2, 8
- D19/95, IRBRD, vol 10, 157
- D92/95, IRBRD, vol 11, 173
- D33/97, IRBRD, vol 12, 228
- D18/99, IRBRD, vol 14, 204

Cheung Mei Fan for the Commissioner of Inland Revenue.

Ho Chi Ming Counsel instructed by Messrs David T K Ng for the taxpayer.

Decision:

1. This is an appeal against the salaries tax assessments raised on the Taxpayer for the years of assessment 1995/96, 1996/97 and 1997/98. The Taxpayer claims that certain amounts paid to him by his employer as a housing benefit should be classified as a refund of rent and should not be considered as an allowance wholly subject to salaries tax.

The facts

2. The following facts are found from the Commissioner's determination and certain additional documents supplied by the parties. The Taxpayer did not dispute them.

1. The Taxpayer had been a shareholder and director of A (Holdings) Ltd ('Company A'). Under an agreement dated 10 August 1995 he sold all his shares in Company A to Company B. Completion of the agreement for the sale and purchase of the shares took place on 6 May 1996. The Taxpayer resigned as director on 31 May 1996. Thereafter, Company B became the sole beneficial shareholder of Company A.
2. By an employment agreement dated 10 August 1995, the Taxpayer was employed by Company A as the managing director of A Service (HK) Co Ltd ('Company C') with effect from 1 August 1995. Clause 2d of that contract ('Contract 1') provided:

'Housing:

1. Up to 31 August 1995 – on full company paid housing

INLAND REVENUE BOARD OF REVIEW DECISIONS

2. After 1 September 1995 – housing allowance \$38,000 per month plus utilities.’
3. On 1 April 1996, the Taxpayer’s employment was transferred to Company B’s wholly owned subsidiary, Company D. All the terms and conditions of his employment from Company A carried over to Company D.
4. Company A and Company D filed employer’s returns in respect of the Taxpayer for the years of assessment 1995/96, 1996/97 and 1997/98 showing the following particulars:

	Year of Assessment 1995/96	Year of Assessment 1996/97	Year of Assessment 1997/98
(a) Employer:	Company A	Company D	Company D
(b) Capacity in which employed:	Managing director	Director of operations	Director of operations
(c) Period:	1-8-1995 to 31-3-1996	1-4-1996 to 31-3-1997	1-4-1997 to 31-3-1998
(d) Income:	\$	\$	\$
Salary	362,000	516,420	578,520
Allowances	<u>-</u>	<u>120,000</u>	<u>456,000</u>
	<u><u>362,000</u></u>	<u><u>636,420</u></u>	<u><u>1,034,520</u></u>
(e) Quarters provided:	Flat in Housing Estate E (‘ the Property’)	the Property	- ¹
Nature of quarters:	Flat	Flat	-
Period provided:	8-1995 to 3-1996	1-4-1996 to 31-3-1997	-
Rent paid by employee to landlord:	304,000	-	-
Rent refund to employee:	304,000	456,000	-

¹ Subsequently Company D claimed that this employer’s return for the year of assessment 1997/98 contained a clerical mistake. On 20 August 1998, it filed a revised return showing the same particulars of income reported by the Taxpayer in his tax return for the year of assessment 1997/98 (fact 7 refers) and also specifying that the Property was provided to the Taxpayer as quarters.

INLAND REVENUE BOARD OF REVIEW DECISIONS

5. In his tax return for the year of assessment 1995/96, the Taxpayer reported the same particulars of income and quarters as per fact 4.
6. In his tax return for the year of assessment 1996/97, the Taxpayer reported the same particulars of income and quarters as per fact 4, except that the period of provision of quarters was stated to be from 1 April 1996 to 31 January 1997.
7. In his tax return for the year of assessment 1997/98, the Taxpayer declared the following particulars:

(i) Salary	\$578,520
(ii) Quarters provided:	-
Address of quarters:	-
Period provided:	1-4-1997 to 31-3-1998
Rent paid by employee to landlord:	\$456,000
Rent refund to employee:	\$456,000
8. In reply to the assessor's enquiries, Company D supplied the following information:
 - (a) The Taxpayer was entitled to housing allowance in accordance with the terms and conditions of his employment agreement. The housing allowance was a fixed cash allowance and it had not set up any control as to how the Taxpayer would spend the allowance.
 - (b) It was unable to provide the exact amount of rent paid by the Taxpayer for the year of assessment 1996/97 (see fact 4(e)) because the Taxpayer handled the rental payment himself.
 - (c) Apart from the employment agreement dated 10 August 1995 (Contract 1, fact 2 refers), there was no other employment agreement or written amendment documenting any change to the terms and conditions of the Taxpayer's employment with Company A or Company D.
 - (d) The Taxpayer was not required to submit copies of his tenancy agreement or monthly rental receipts to Company D before it released the monthly housing allowance to him.

INLAND REVENUE BOARD OF REVIEW DECISIONS

9. In support of his objections to assessments raised by the assessor, the Taxpayer submitted the following documents to support his claim that the housing allowances paid to him were actually refunds of rent:
 - (a) A copy of an employment agreement with Company A dated 10 August 1995 ('Contract 2'). This contract contained the following clause 2d:

' Housing Benefits:

Staff quarters will be provided. If staff quarters is not available, company will refund rent paid by staff.'
 - (b) A copy of an unstamped tenancy agreement dated 1 November 1995 signed by the Taxpayer as tenant and by Company F as landlord for the letting of the Property for 36 months commencing on the same date at a monthly rent of \$38,000. The agreement was submitted for stamping on 25 August 1998. The Taxpayer claimed that he had provided a copy of the agreement to Company D.
 - (c) Rental receipts issued by Company F in respect of the Property from April 1996 to March 1997 showing monthly payments of rent of \$38,000. The Taxpayer claimed that he had submitted these to Company D for inspection before claiming rental reimbursements.
10. The assessor ascertained the following information in relation to Company F:
 - (a) The Taxpayer and his wife were its only shareholders and directors.
 - (b) The company acquired the Property on 16 August 1995 for a consideration of \$9,800,000.
 - (c) The following rental income was shown in Company F's profit and loss accounts for the three years ended 30 September 1995 (nil), 1996 (\$456,000) and 1997 (\$456,000).
11. At the assessor's request, Company F supplied the following information and documents:
 - (a) Company F settled the monthly rent for the Property by debiting, on a monthly basis, the Taxpayer's current account maintained with it.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (b) Copies of the rental receipts for the Property from April 1997 to March 1998 showing monthly payments of rent of \$38,000.
12. In response to the assessor's enquiries, Company A provided the following assertions in relation to the Taxpayer's employment:
- (a) Contract 1 (fact 2 refers) was a draft document for initial discussion relating to the sale of the shares in Company A by the Taxpayer to Company B. Amendments were made to the terms in the course of negotiation. These were reflected in the formal employment agreement evidenced by Contract 2 (fact 9(a) refers).
 - (b) The amount of rent refunded to the Taxpayer during the period from August 1995 to March 1996 was \$38,000 per month.
 - (c) The Taxpayer had submitted copies of the tenancy agreement in respect of the Property (fact 9(b) refers) and rental receipts for the months September 1995 to March 1996 before it released the refund to the Taxpayer.
13. The assessor considered that the housing allowances paid to the Taxpayer by Company A and Company D in the amounts of \$304,000 (for the year of assessment 1995/96) and \$456,000 (for each of the years of assessment 1996/97 and 1997/98) were not refunds but cash allowances fully assessable to tax.
14. The Commissioner upheld the assessor's view and rejected the Taxpayer's objection.

The issue in dispute and applicable legal principles

3. The parties agree on these. The issue before us is whether the sums paid to the Taxpayer by Company A of \$304,000 (for the years of assessment 1995/96) and by Company D of \$456,000 (for each of the years of assessment 1996/97 and 1997/98) were cash allowances taxable under section 9(1)(a) of the IRO or refunds of rent within section 9(1A)(a).

4. In D8/82, IRBRD, vol 2, 8 it was stated:

'To label a payment in addition to salary as a "housing allowance" or to split a taxpayer's remuneration into two parts and call one part a "housing allowance" would not necessarily render that portion so described as exempt

INLAND REVENUE BOARD OF REVIEW DECISIONS

income. It is quite capable of falling into the category of a perquisite or allowance so as to be taxable by virtue of section 9(1).

If a place of residence is not provided by the employer or an associated company, the taxpayer must be able to show that the sum he has received and claimed by him as a "housing allowance" is a rental refund, either wholly or in part, which would entitle him to such tax relief as mentioned in section 9(1A)(a), (b) or (c).'

5. The ordinary meaning of 'refund' connotes a repayment or reimbursement, not mere payment. There must be actual payment of rent in the first place before a subsequent reimbursement by the employer could constitute a refund of rent (see D19/95, IRBRD, vol 10, 157 and D92/95, IRBRD, vol 11, 173).

6. One of the indicia distinguishing a rent refund from cash allowance is the control exercised by the employer over a refund to ensure that it cannot be spent in any way the employee wants. This control must exist as a matter of fact and not just in theory (see D33/97, IRBRD, vol 12, 228). The question whether a housing allowance is a rent refund or a cash allowance also depends on the parties' intention at the time they enter into the contract of employment (see D18/99, IRBRD, vol 14, 204).

The evidence

7. At the hearing, the Taxpayer was represented by Mr Ho Chi-ming of counsel. Mr Ho called three witnesses, Ms G, Mr H and the Taxpayer. They were all cross-examined at length by the Commissioner's representative, Ms Cheung Mei-fan.

8. Ms G, the accounting manager of Company D, adduced the following evidence.

1. She handled the accounting, including the employees' payroll, for the D group of companies in Hong Kong, including Company A.
2. At all material times she prepared the payroll for employees of Company A or signed the payroll as the authorised signatory when she was promoted to accounting manager in 1997. The finance director, Mr H, countersigned the payroll.
3. Her employment was transferred from Company A to Company D in October 1996 upon the merger of the two companies. Prior to that date she did not prepare payrolls for Company D, but she did keep staff accounting records, including those for the Taxpayer which contained various rental receipts as described in the following paragraph.

INLAND REVENUE BOARD OF REVIEW DECISIONS

4. Commencing from September 1995 the Taxpayer gave her an original rental receipt every month for the purpose of claiming reimbursement of rent paid by him. She confirmed that she had received the rental receipt every month from September 1995 to March 1998 inclusive and that for the period from September 1995 to March 1996 inclusive these were kept in the records held by Company A. For the period from April 1996 to March 1998 inclusive Company A continued to keep the receipts. Prior to October 1996 she did not pass any of the receipts to Company D. During this period Company A paid the Taxpayer's housing benefit and then billed the payments to Company D. From October 1996 onwards the Taxpayer's housing benefit was paid directly by Company D.
5. At all relevant times, the receipts were considered accounting vouchers and were not passed to the payroll department.
6. The Taxpayer gave her a copy of the rental agreement in respect of the Property (fact 9(b) refers) in or about November 1995. This was then kept in the personnel file held by Company A.
7. The pay date for employees was originally on the 28th and was later changed to the 25th of each month. The Taxpayer would give her a rental receipt sometime before that date. The payroll was then prepared. The Taxpayer's bank account would be credited with the housing reimbursement of \$38,000, his basic salary and other income due to him. She stated that submission of the receipt to her by the Taxpayer was a condition for payment to him of his housing benefit in the amount set out in his employment agreement.
8. On some occasions when the Taxpayer failed to hand the rental receipt to her, she would remind him to do so. The only exception was the rental receipt for August 1995. She could not recall why the receipt for this month was not produced to Company A.
9. Information contained in the Taxpayer's payroll slip included his salary and housing benefit paid in accordance with his employment agreement.
10. She filed the employer's return for the Taxpayer for the year of assessment 1995/96 (fact 4(e) refers). That return stated that the quarters were provided to the Taxpayer from August 1995 to March 1996 inclusive even though the tenancy agreement submitted to her stated that the lease commenced on 1 November 1995. She recorded this item in this way because the Taxpayer was living in the Property as at March 1996 (she thus copied the address to

INLAND REVENUE BOARD OF REVIEW DECISIONS

the employer's return) and the commencement period for the housing benefit was August 1995 (in accordance with the Taxpayer's employment agreement). The Taxpayer had not provided her with a copy of a tenancy agreement for the period August 1995 to October 1995 inclusive. She stated that she was able to verify correct payment of the housing benefit because he submitted to her the rental receipts for September and October 1995 (which did not show the address of the property rented) in the amount of his entitlement provided in his employment agreement. In relation to the month of August 1995, when no receipt was provided by the Taxpayer, she included a sum of housing benefit for preparing the Taxpayer's payroll because she had specific approval from her boss, Mr H, who then countersigned for her to authorise the payment. She reiterated that for all other months she had the rental receipt to authorise payment.

11. She was not responsible for filing the employer's return for the Taxpayer for the years of assessment 1996/97 and 1997/98.

9. The second witness, Mr H, the finance director of both Company A and Company D, adduced the following evidence.

1. At all material times he approved the payroll for all employees of Company A and Company D. Ms G was responsible for preparation of the payroll.
2. When Company B acquired all the shares in Company A under an agreement dated 10 August 1995, it was agreed that the Taxpayer be employed by Company A with effect from 1 August 1995. A draft contract of employment dated 10 August 1995 (Contract 1) was prepared and signed by the Taxpayer. When Contract 1 was drafted and signed this was done in a hurry because it was necessary to send the document to Country I where the agreement for the sale and purchase of the shares was signed.² At that time he was not sure what terms and conditions should have been included in the contract of employment.
3. Contract 1 was later revised and replaced by another employment agreement also dated 10 August 1995 and signed by the Taxpayer (Contract 2). In Mr H's words, Contract 1 was only a commitment that the Taxpayer would work for Company A for three years and this was the critical issue. After he returned from Country I, Company A entered into negotiations with the Taxpayer to finalise all the terms and conditions of his employment. In the

² Under the agreement for the sale and purchase of the shares, it was a condition precedent (that must be satisfied before completion) that the Taxpayer entered into an employment agreement on essentially the same terms as those set out in both Contract 1 and Contract 2.

INLAND REVENUE BOARD OF REVIEW DECISIONS

event, revisions were made to provide the Taxpayer with a more clearly defined housing benefit, which previously, as a consultant to Company A, he had not been entitled to receive. Mr H had personal knowledge of all these matters because he prepared both drafts for the approval of Mr J, the managing director of Company A.

4. When the housing benefit provision in Contract 2 was revised, he knew that the Taxpayer had rented a property in District K for \$46,000 per month. This amount was above Company A's budget (which was only \$38,000 per month). Company A normally provided company quarters for its senior employees but it had no vacant quarters in August 1995. It thus gave the Taxpayer time to look for another apartment at a cheaper rent. Although Mr H admitted that there was no ceiling for housing benefit in Contract 2,³ he stated that it should have been included, and noted that the agreed figure of \$38,000 per month was actually refunded to the Taxpayer. He did not recall when Contract 2 was signed, but thought it might have been some two to three months after he returned from Country I when the Taxpayer had secured a new quarter.
5. Referring to the housing benefit provided in Contract 2, he stated that it was essential for the Taxpayer to produce evidence of paying rent before he could receive a rental refund. Ms G would ensure that the Taxpayer would submit to her a rental receipt for each month.
6. He confirmed that the Taxpayer had initially produced an unstamped tenancy agreement (fact 9(b) refers) and monthly rental receipts for the purpose of claiming a rental refund. He could not recall when the stamped agreement was produced.
7. He referred to various letters written to the assessor by Ms L, office manager of Company D. These letters stated that the housing allowance was a fixed cash allowance to the Taxpayer. They also stated that Company D had not set up any control relating to spending the allowance, and that the Taxpayer was not required to submit a copy of the tenancy agreement or rental receipts before the monthly allowance was released to him (fact 8 refers). He stated that these letters were incorrect and that Ms L wrote them on her own without consulting him. She did not copy any of these letters to him. Ms L's supervisor was Mr M, the senior director of Company D.
8. Subsequently, he undertook the task of answering the assessor's enquiries because he felt that Ms L was not fully aware of, or capable of handling,

³ Contrast the terms of Contract 1 that provided for a ceiling of \$38,000.

INLAND REVENUE BOARD OF REVIEW DECISIONS

questions relating to the employment of Company A's director grade officers. Ms L left employment with Company D in April 2000. By that time he had already been handling the assessor's enquiries concerning the Taxpayer for some 12 to 18 months.

9. Ms L had only supplied the assessor with Contract 1. She could not have supplied the assessor with Contract 2 because she did not have access to it.
10. He reiterated that the housing benefit paid to the Taxpayer was a refund of rent and not a fixed monthly allowance and that it was essential for the Taxpayer to submit evidence of payment of rent before the refund would be released to him. No guidelines were however given to staff as to the procedures they should follow before claiming a refund.
11. He personally saw a copy of the tenancy agreement between the Taxpayer and Company F (see point 6 above) but stated that he did not need to personally see the rental receipts because these were checked by Ms G.
12. Referring to the housing benefit for August 1995, the only month for which no rental receipt was received from the Taxpayer, he stated that Company A paid the Taxpayer \$38,000 instead of the Taxpayer's actual rental payment of \$46,000. This was a one-off payment that was only appropriate because it was made in a transition period when the Taxpayer's status with Company A changed from consultant to employee and he was still residing in his former quarter in District K. He stated that no rental receipt was available for this month because the Taxpayer only had an oral lease with the landlord. In response to a question why he could verify this payment without seeing any lease agreement, he stated that he trusted the Taxpayer and had known him for over ten years.
13. Referring to the employer's return for the year of assessment 1995/96 (fact 4(e) refers), he stated that a mistake had been made and that reference should also have been made to the fact that from August to October 1995 the Taxpayer received a rental refund for his former quarter in District K. He stated that what was most important was that, as a matter of fact, the Taxpayer had paid rent and this entitled him to a refund in accordance with his contract of employment.
14. The Taxpayer's salary increment and other employment benefits, such as participating in the staff provident fund, were not based upon the fact that he also received a rent refund of \$38,000 per month.

INLAND REVENUE BOARD OF REVIEW DECISIONS

15. He rejected the suggestion that Company A and Company D had not properly put into practice or followed any system of control to ensure the payment of \$38,000 was in truth a rent refund, 'except maybe within the first two to three months [of the Taxpayer's employment]' .
10. The third witness was the Taxpayer himself. He adduced the following evidence. The first part of that evidence related to various uncontested facts set out above. They are not repeated here.
1. Before moving to the Property, at all relevant times he lived in a property located in District K that was rented under a tenancy agreement between Company F and the landlord. The monthly rent was \$46,000. The tenancy agreement was concluded orally. He could not recall when this tenancy commenced, but thought it might be six or seven years ago. He also could not recall if he paid any rent to Company F prior to August 1995.
 2. For the period August to October 1995 no formal tenancy agreement had been entered into between him and Company F in relation to the District K property. No rental income was included in the profit and loss account for Company F for the year ended 30 September 1995. When asked to explain this he replied that the accountant had made a mistake.
 3. Notwithstanding point 2 above, he claimed that Company A reimbursed him for his monthly rental in respect of the District K property for the three months of August, September and October 1995 up to the limit of \$38,000 as stipulated in his employment agreement. For each of these three months he paid the sum of \$38,000 to Company F in part settlement of the rent due to the landlord. Receipts were issued to him by Company F and for September and October 1995 he handed them to Ms G for the purpose of claiming a rental refund. He did not hand over the receipt for August 1995 and did not recall why he had not done so. Subsequently, however, he indicated in cross-examination that Company F only started to issue rent receipts to him from September 1995.
 4. Referring to Contract 2 he stated that Company A originally intended to provide him with staff quarters but in August 1995 they were occupied. He thus had to find another apartment and the rent paid would be refunded (but only up to a maximum amount of \$38,000 per month).
 5. Company F acquired the Property on 16 August 1995. He moved into the Property in November 1995. He entered into a tenancy agreement with Company F for lease of the Property (fact 9(b) refers) commencing on 1

INLAND REVENUE BOARD OF REVIEW DECISIONS

November 1995 for a term of three years at a monthly rent of \$38,000. He produced a copy of the agreement to Company A for the purpose of claiming a refund of rent.

6. Thereafter, he would pay the rent of \$38,000 per month for the Property and Company F would issue him with a receipt. He would then hand over the receipt to Ms G.
7. He acknowledged that the tenancy agreement between him and Company F in relation to the Property did not contain the usual terms relating to deposit, time of rent payment, burden for repairs etc but responded that these were not necessary. In his view, the most important issues were that this was a real agreement and covered the key matter of the use of the Property for a stated sum of rent. He stated that the monthly rent of \$38,000 was fair but acknowledged that he had not made any detailed study of fair market rent for comparable properties. He also acknowledged that the rental figure was arbitrarily set at \$38,000 per month to reflect the terms set out in his contract of employment for housing benefit.
8. It was always intended for the tenancy agreement to be legally binding. In 1998 he discovered that to be enforceable the agreement had to be stamped. Thereupon he arranged to stamp the agreement.
9. He did not know why the profit and loss account for Company F for the year ended 30 September 1996 included rental income for twelve months when the rental income from the Property only commenced from 1 November 1995. The accountant who compiled the accounts might have made a mistake because every month Company F paid the monthly mortgage payment for the Property from his rent payment of \$38,000 together with his additional contribution of \$16,000 (total \$54,000). The accountant might have treated the sum of \$54,000 contributed entirely by him in October 1995 as wrongly including a rental payment of \$38,000. He did not check the accounts personally before signing them. He simply relied upon the accountant who was a chartered certified public accountant. Later in his evidence he seemed to suggest that no mistake was made because the total amount of rent included in the accounts included his payment to Company F of \$38,000 for October 1995 as evidenced by an entry in his current account with Company F stating: ' 1 October 1995 rental income accrued' .
10. He acknowledged a mistake in the employer's return for the year of assessment 1995/96 (fact 4(e) refers) and in his tax return for the year of assessment 1995/96 (fact 5 refers) which made no reference to provision of

INLAND REVENUE BOARD OF REVIEW DECISIONS

the District K quarters for the period August to October 1995. He noted, however, that the total amount claimed for rent refund was correct.

11. Referring to the letters written to the assessor by Ms L stating that the housing allowance was a fixed cash allowance, that Company D had not set up any control relating to spending the allowance, and that he was not required to submit a copy of the tenancy agreement or rental receipts before the monthly allowance was released to him (fact 8 refers), he stated that these letters were untrue. Ms L was never employed by Company A and was thus not aware of the true position. He stated that each month he needed to produce a rental receipt from Company F to Company A before the allowance could be released to him for rental reimbursement. He also stated that it was untrue that Company A could not provide particulars of the rent paid by him for the year ended 31 March 1997 (fact 8 refers) because he handed the rental receipts to Ms G and they were always in Company A's files. This could be proved from the Employer's Return filed by Company A that showed the correct amount of rent refunded to him for that year. He stated that Ms L wrote these letters without seeking clarification from either himself or Mr H. She did not provide a copy of the letters to him or to Mr H.
12. Ms L was in no position to provide Contract 2 to the assessor because she did not have a copy of this agreement. He opined that Mr H, who is one of the senior management team of Company D, would have a copy. He reiterated however that Contract 2 was the proper contract to govern his terms of employment because Contract 1 was prepared hurriedly for the purpose of completing the sale of his shares in Company A. He could not recall when he signed Contract 2.

Decision and reasons therefor

11. We have decided to consider this appeal in relation to two distinct periods (1) from August to October 1995 (when the Taxpayer lived in the District K property) and (2) from November 1995 to March 1998 (when he lived in the Property). We first state, however, our finding that each of the three witnesses called on behalf of the Taxpayer impressed us. The evidence of each was clear, forthright and without artifice. Despite lengthy and probing cross-examination by the Commissioner's representative, none was shaken in their evidence. In the result, we accept that evidence. We also note that the totality of the sworn evidence basically forms a coherent and consistent picture.

(1) November 1995 to March 1998

INLAND REVENUE BOARD OF REVIEW DECISIONS

12. Having carefully considered all the evidence before us, we find that for the period November 1995 to March 1998 the monthly sum of \$38,000 paid to the Taxpayer by the relevant employer was a refund of rent. Specifically, we find that the Taxpayer has proved the contentions that (1) a housing benefit of \$38,000 per month was agreed to be provided to the Taxpayer in his contract of employment, (2) under that contract, paying particular attention to the provision for housing in both Contract 1 and Contract 2, the parties intended to provide a housing benefit for the Taxpayer up to a maximum amount of \$38,000 per month in the form of a refund of rent where employer accommodation was not available to the Taxpayer, (3) the Taxpayer had entered into a valid tenancy with Company F under which he paid a monthly rent to Company F of \$38,000 for use of the Property, (4) a copy of that lease was given to Company A and (5) the Taxpayer obtained rental receipts from Company F for each month and these were then passed to Ms G who at all material times was responsible for the payroll of Company A and, later, Company D. It is inherent in our decision, and we so find, that sufficient control was exercised by the employer to ensure that the monthly payment of \$38,000 was a refund of rent and not simply a cash allowance that the Taxpayer could spend as he wished.

13. In relation to points (1) and (2) above, the Commissioner's representative, Ms Cheung Mei-fan, made a strenuous effort in her cross-examination of both Mr H and the Taxpayer to show that Contract 2 was produced solely for tax effect. In other words, she endeavoured to prove that Contract 2 was only produced to support a claim that the amounts in dispute were refunds of rent rather than straight out cash allowances. In her final submission, however, Ms Cheung did not press this contention upon us. We are convinced, after considering all relevant evidence, that Ms Cheung made the correct decision in this matter. In this regard we note, if only for the sake of completeness, that the evidence of both Mr H and the Taxpayer relating to the drafting and finalisation of these documents was consistent and possessed the clear stamp of truth. The picture painted by both witnesses accorded with the commercial reality whereby Contract 1 had to be drawn up and executed quickly as part and parcel of the agreement for the sale of the Taxpayer's shares in Company A. Then, within a reasonably short period of time, Contract 2 was prepared and executed to amend the terms of the employment contract to more clearly reflect the parties' intention regarding the Taxpayer's entitlement to the provision of housing. In our view, that intention was clear – the Taxpayer was to obtain a housing benefit of \$38,000 per month in the form of a rental refund if, as was the case, employer accommodation was not available.

14. In relation to point (3) above, Ms Cheung contended that the Taxpayer did not receive a rental refund because he had no intention to enter into a legal lease with Company F. Ms Cheung supported her contention by reference to the facts that the agreement was not initially stamped and that, in any event, it did not contain the usual terms and covenants found in leases for residential premises. We accept the Taxpayer's evidence that initially he had not appreciated the problems that might arise from failure to stamp the lease (see Stamp Duty Ordinance, section 15(1)). But we also note that he cured these problems by late stamping. We are also not prepared to hold that the absence of the usual lease terms and conditions in the tenancy agreement must mean that the payments in dispute cannot be classified as refunds of rent. In our view, the evidence

INLAND REVENUE BOARD OF REVIEW DECISIONS

clearly supports the conclusion that from 1 November 1995 onwards, the Taxpayer did pay a sum of \$38,000 monthly to Company F for the use of the Property. That evidence includes the Taxpayer's sworn statements to us, the fact that the tenancy agreement was prepared and executed, that rental receipts were given by Company F, and that the accounts of Company F recorded rental payments from the Taxpayer for each month from November 1995 to March 1998 inclusive. We note specifically, in light of the clear oral evidence before us tested by cross-examination, that these rental receipts were produced contemporaneously and were submitted monthly to Ms G. All these matters are consistent with the conclusion that during this period the Taxpayer paid \$38,000 rent to Company F for the use of the Property.

15. Further in relation to point (3) above, Ms Cheung contended that the Taxpayer did not pay rent because this merely involved debiting sums to his current account with Company F. We reject this argument. At all relevant times, the current account of the Taxpayer with Company F was in credit in the amount of between \$4,480,000 and over \$6,000,000. This amount represented substantial advances previously made by the Taxpayer for the benefit of Company F. We know of no authority, and none was submitted to us, that states that a payment of rent must be a direct physical act and cannot be satisfied by way of offsetting moneys owed by the lessor to the lessee.

16. We appreciate that the statements made in Ms L's letters to the assessor (fact 8 refers), as well as the various returns filed by the employer and the Taxpayer with the assessor (facts 4 and 5 refer), in varying degrees of strength do not support the Taxpayer's submission. We have thus been cautious in our evaluation of the sworn evidence. We record that we did not simply accept the Taxpayer's case at face value. Indeed, a major difficulty we saw in this case is that the various letters and returns issued by both Company A and Company D in respect of the Taxpayer were confusing, incomplete and inconsistent.

17. We deal first with Ms L's letters. Having considered all the evidence before us we find that Ms L lacked complete knowledge of the Taxpayer's entitlement to housing benefit. In the result we agree with counsel for the Taxpayer that the letters written by Ms L to the assessor are of negligible evidential value. We prefer to accept the consistent oral evidence of the three witnesses and reiterate the findings on that evidence that we have reached above.

18. We note also the Taxpayer's admission that mistakes in various returns lodged with the assessor were made through inadvertence. Notwithstanding these matters, as stated above, we have no doubt that both the Taxpayer and his employer intended to provide him with a housing benefit structured as a rental refund of \$38,000 per month. As also indicated above, we have found that the employer exercised sufficient control, by procuring the submission of the tenancy agreement and the rental receipts, to ensure that benefit did not simply take the form of a cash allowance that he could spend in whatever way he wished. We find additional support for this conclusion from the fact that the Taxpayer was not entitled to bonus, increment or employer provident contribution in respect of the monthly payment of \$38,000.

INLAND REVENUE BOARD OF REVIEW DECISIONS

(2) August 1995 to October 1995

19. During this earlier period the Taxpayer lived in the District K property. There was evidence before us, which we accept, that Company F leased this property from the landlord at a monthly rent of \$46,000. This is an amount well in excess of the Taxpayer's entitlement to housing benefit as provided in his contract of employment. There is some evidence that the Taxpayer entered into a lease with Company F for use of this property. (For example, rental receipts were provided for September and October, although not for August; and in October the Taxpayer's current account with Company F was debited with a monthly charge for rent.) However, on the balance of probabilities, we conclude that the Taxpayer did not incur rent for occupation of this property. We support our conclusion by noting (1) no lease was produced in evidence (although we appreciate this is not conclusive), (2) no rent for the period August to September 1995 was recorded in the profit and loss account of Company F and (3) unlike the subsequent period considered above, the oral evidence (see, for example, Mr H's evidence above at point 15 and the Taxpayer's evidence above at points 1, 2 and 3) was not as compelling or as clear in the admittedly hectic period between the sale of shares in Company A until the Taxpayer moved to the Property. It follows that the payments of \$38,000 per month made to the Taxpayer for this earlier period were properly subject to salaries tax.

(3) Summary

20. Taking the two periods as a whole, it is our conclusion that at all relevant times the Taxpayer and his employer did intend to provide a housing benefit in the form of a rental refund amounting to \$38,000 per month. When the contract of employment commenced in August 1995, the Taxpayer was living in accommodation rented by his family controlled company at a lease that well exceeded his housing benefit. In the month of August, we infer that the Taxpayer's affairs and those of Company A were hectic up to and after the sale of share. There was neither time, nor sufficient consideration given, to arrange a proper lease agreement between the Taxpayer and Company F. Although the Taxpayer made some efforts in September and October 1995 to rectify this, in the result these were insufficient for us to conclude that the Taxpayer had entered into a new lease with Company F for a rent of \$38,000. In short, there was no rental payment during this period by the Taxpayer that could be the subject of any refund by the employer.

21. However, the situation changed in November 1995 when the Taxpayer moved to the Property. Care was then taken to prepare a lease, rental payments were made and the rental income was properly recorded in the accounts of Company F. Receipts were then given for the rent paid and the Taxpayer supplied his employer with all relevant documentation to support a payment of housing benefit. In the event, rental payments were made and then properly refunded in accordance with the contract of employment.

(4) Conclusion

INLAND REVENUE BOARD OF REVIEW DECISIONS

22. The appeal is partly allowed. We order that the assessments be revised in accordance with our decision that the payment of \$38,000 per month for the period November 1995 to March 1998, but not from August 1995 to October 1995, are refunds of rent.