

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D22/01

Salaries tax – deduction – home loan interest – refinance of mortgage – section 26E of the Inland Revenue Ordinance (‘ IRO’).

Panel: Andrew Halkyard (chairman), Patrick Ho Pak Tai and Paul Mok Yun Lee.

Date of hearing: 4 April 2001.

Date of decision: 4 May 2001.

The taxpayer appealed against the salaries tax assessment for the year of assessment 1998/99. The taxpayer claimed that a deduction should be allowed for the maximum amount as specified by the IRO of \$100,000 for home loan interest that he paid consequent upon the refinancing of his residence.

In essence, the taxpayer put his claim on two bases:

1. Because he switched to a new organization, which included the right to participate in its home loan interest subsidy scheme, he was obliged to refinance his residence.
2. In any event, it was unfair for the assessor to base the formula allowing interest deduction by reference to the date he obtained refinancing from a finance company, that is, 6 April 1995. He contended that the formula should take into account the fact that he had to first settle a government loan in September 1994. He reiterated that from September 1994 until April 1995 he also had to pay the interest under the original mortgage loan from his own resources.

Held:

1. In terms of section 26E of the IRO, the interest on the finance company’ s mortgage loan can only be deductible to the extent that the loan was applied to acquire the taxpayer’ s residence. On the facts, the only relevant application of this mortgage loan was to the extent that the original mortgage loan was repaid. There was no evidence to indicate that the balance was applied to acquire the taxpayer’ s residence.

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2. As to the taxpayer's second argument, the Board would have been prepared to alter the numerator of the assessor's formula if the evidence showed that the finance company's mortgage loan was applied to repay the mortgage loan from the Hong Kong Government. However, that was not the case.

Appeal dismissed.

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

Decision:

1. This is an appeal against the salaries tax assessment raised on the Taxpayer for the year of assessment 1998/99. The Taxpayer claims that a deduction should be allowed for the maximum amount as specified by the IRO of \$100,000 for home loan interest that he paid consequent upon the refinancing of his residence.

The facts

2. These are not in dispute. They are set out, and we so find, in the Commissioner's determination dated 27 October 2000 and, as set out below, in the evidence given by the Taxpayer to this Board. The essential facts are as follows:
 - (a) The Taxpayer completed the purchase of his residence in October 1990 for a purchase price of \$1,890,000.
 - (b) He financed the purchase from three sources: a loan from the Hong Kong Government of \$378,000, a mortgage loan from Bank A of \$980,000 and from his own resources.
 - (c) He fully repaid the Government loan in September 1994. On settlement of that loan, the outstanding principal repaid was \$239,032. He stated that he borrowed money from his relatives to repay this loan and that he subsequently repaid his relatives out of his monthly salary. He stated that he knew that he was required to fully repay the Government loan before he could join the home loan interest subsidy scheme operated by Organization B, which organization he joined in November 1994.

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- (d) From November 1994 until April 1995, he paid the interest on the Bank A mortgage on his own and from his own resources.
- (e) On 6 April 1995, in accordance with the home loan interest subsidy scheme operated by Organization B, he refinanced his residence by obtaining a mortgage loan of \$1,890,000 from Finance Company C.
- (f) Also on 6 April 1995, using part of the moneys from the Finance Company C mortgage loan, he fully repaid the Bank A mortgage loan. On that date the outstanding principal repaid was \$530,917.
- (g) For the year ended 31 March 1999, he continued to be employed by Organization B. He resided in the residence and paid interest on the Finance Company C mortgage loan of \$183,404.
- (h) The Taxpayer claims that for the year of assessment 1998/99 he should be entitled to a deduction for all of the home loan interest expense set out at fact (g) (subject to the statutory maximum limit of \$100,000).
- (i) In her determination, the Commissioner rejected this claim in the following terms:

‘ On the facts before me, I am unable to accept the Taxpayer’s claim that the full amount of interest on the Finance Company C loan (subject to the ceiling of \$100,000) qualifies for deduction as home loan interest. Section 26E(9) clearly provides that a home loan is only confined to a loan of money that is applied wholly or partly for the purchase of a dwelling. Section 26E(3)(a) further provides that if the home loan was not applied wholly for the acquisition of the dwelling, only a part of the interest paid can be allowed for deduction. The Taxpayer obtained the Finance Company C loan some four years after his acquisition of the Property. The amount of the Finance Company C loan far exceeded the outstanding amount of the Bank A loan. It is his case that “the initiation of this home loan was for the sake of home loan interest subsidy scheme of Organization B”. Accordingly, it is clear that this loan was not obtained for or wholly applied in the acquisition of his residence. I endorse the assessor’s computation of the allowable home loan interest in accordance with section 26E(3)(a), which is reasonable in the circumstances of this case’ [The Commissioner thus confirmed the assessor’s computation of the interest deduction on the basis of the formula: \$183,404 (fact (g)) x 530,917 (fact (f)) / 1,890,000 (fact (e)) = \$51,520].

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The Taxpayer's contentions

3. During the hearing before us, the Taxpayer repeated his claim set out at fact (h) and reiterated the arguments contained in his letters to the assessor, copies of which were produced to us. In essence, the Taxpayer put his claim on two bases:

- (a) Because he switched to the Organization B terms of service, which included the right to participate in its home loan interest subsidy scheme, he was obliged to refinance his residence. If he did not do so, he would not be able to obtain the full housing benefit to which he was entitled. In this regard, he noted that his residence had increased in value from \$1,890,000 at the time of purchase to \$5,500,000 in early 1995. It was a normal and acceptable practice for eligible Organization B staff to re-mortgage a self-owned property, instead of buying a new property, so as to be able to obtain the full entitlement under the above scheme.
- (b) In any event, it was unfair for the assessor to base the formula allowing interest deduction by reference to 6 April 1995, the date he obtained the refinancing from Finance Company C. The formula should take into account the fact that he had to first settle the Government loan of \$239,032 (fact (c)) plus interest of \$1,170 in September 1994. In this regard, he reiterated that from this time until April 1995 he also had to pay the interest under the Bank A mortgage loan from his own resources.

Decision and reasons therefor

4. In relation to the Taxpayer's first argument above, we find no fault with the reasoning of the Commissioner. In essence, the Taxpayer was asking us to accept that when he refinanced the residence in April 1995, and taking into account the increase in value since purchase, this essentially amounted to a new acquisition. We reject this argument. Our task is to apply the law to what the Taxpayer actually did – namely, refinance a residence that he already owned, and not to what he could have done – namely, purchase a new residence. In terms of section 26E of the IRO, the interest on the Finance Company C mortgage loan, which we accept as a 'home loan' for the purposes of subsection (9), can only be deductible to the extent that the loan was applied to acquire his residence. On the facts before us, the only relevant application of this mortgage loan was to the extent that the Bank A mortgage was repaid. We do not know, and were not told by the Taxpayer, where the balance of the mortgage funds was applied. Suffice to say that there was no evidence before us to indicate that the balance was applied to acquire his residence.

5. Turning to the Taxpayer's second argument above, we note that we would have been prepared to alter the numerator of the assessor's formula if the evidence showed that the Finance Company C mortgage loan was applied to repay the mortgage loan from the Hong Kong Government. However, as is clear from the Taxpayer's evidence at fact (c), this was not the case.

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6. In conclusion, there is no evidence before us that would entitle us to reject the Commissioner's determination. We therefore confirm the assessment and dismiss the appeal.