Case No. D23/05

Salaries tax – whether or not the housing assistance received was a refund of rent and not fully assessable to salaries tax – section 9(1)(a), 9(1)(c), 9(1A)(a)(i), 9(1A)(a)(ii), 9(1A)(c) and 9(2) of the Inland Revenue Ordinance ('IRO') – the test to determine whether a payment was a rental refund – whether or not the Company pays the rent payable by the appellant under the statutory term of section 9(1A)(a)(i).

Panel: Andrew J Halkyard (chairman), Francis T K Ip and Paul David Stuart Moyes.

Dates of hearing: 21 March and 18 April 2005.
Date of decision: 9 June 2005.

The appellant was employed by Company A and the appellant was entitled to Accommodation and Rental Assistance in accordance with Company A's condition of employment. The appellant claims that the housing assistance he received from his employer was a refund of rent and not fully assessable to salaries tax.

At all relevant times, and in accordance with Company A's housing scheme, the appellant had leased a vessel from Company C (first Yacht B and then Yacht D) and in both cases the appellant had sent to Company A at the commencement of the lease a properly executed lease adjudicated by the Stamp Office. The appellant was a director of Company C. The appellant argued that Company A simply treated the appellant as an owner occupier for its own administrative purposes in reporting Company A's housing assistance to the Inland Revenue Department and this was not justified since there had been no change to the Accommodation and Rental Assistance. The appellant further contended that the appellant had incurred an actual documented liability to pay rent and Company A directly paid the landlord. Section 9(1A)(a)(i) was satisfied and the amounts in dispute should be exempt from salaries tax.

The issue is whether the sums paid by Company A to the appellant are allowances chargeable to salaries tax in terms of section 9(1)(a) or refunds of rent within the meaning of section 9(1A)(a)(ii). In the former case, the sums should be assessed in full. In the latter case, the taxpayer should be assessed only on the rental value of the place of residence provided to him by Company A in accordance with sections 9(1)(c), 9(1A)(c) and 9(2).

Held:

1. The test to determine whether a payment was a rental refund is to ascertain the intention of the parties as at the time of the payment by the employer (CIR v Page (2002) 5 HKTC 683 applied).

2. Having considering the evidence in the case, the Board has no doubt that the intention of the parties when the amounts in dispute were paid was for Company A to pay to the appellant assistance to acquire a residence through his service company, Company C, by helping finance the costs of the relevant mortgage. The Board concludes that Company A at all relevant times provided cash allowances to the appellant which are subject to salaries tax under section 9(1)(a) and they were not refunds of rent for the purposes of sections 9(1)(c), 9(1A)(c) and 9(1A)(a)(ii).

3. The Board cannot conclude under the statutory term of section 9(1A)(a)(i) that Company A 'pays the rent payable by the taxpayer'. Company A did not pay any rent – it just transferred money into Company C's bank account, by way of a payroll deduction from the appellant's contractual salary, at the appellant's direction. However one looks at it, the appellant paid the rent of which he was liable. Company A simply acted as a conduit for that payment.

4. The Board cannot see how section 9(1A)(a)(i) could apply in the absence of a contractual commitment by the employer to provide a rental benefit for the employee or, at least, clear evidence that in addition to the employee's other remuneration the employer intended to discharge the employee's liability to pay rent as consideration for the services rendered under the employment. Neither of these conditions is satisfied in the present case.

5. The clearest example for the operation of section 9(1A)(a)(i) is where the contract of employment provides that the employer agrees to bear the cost of the employee's rent (typically up to a maximum amount) for premises leased by the employee. That payment may be (typically) part or (uncommonly) all of the employee's remuneration from the employment.

Appeal dismissed.

Cases referred to:

CIR v Page (2002) 5 HKTC 683
D8/82, IRBRD, vol 2, 8

Taxpayer represented by his representative.
Yeung Siu Fai and Tang Hing Kwan for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal against salaries tax assessments raised on the Appellant for the years of assessment 2001/02 and 2002/03. The Appellant claims that the housing assistance he received from his employer was a refund of rent and not fully assessable to salaries tax.

The facts

2. The basic facts, which are not in dispute, are set out in the Deputy Commissioner's determination dated 26 November 2004. On the basis of that determination and the documents submitted to us by both parties, we find the following facts.

(1) Since 1988 the Appellant has been employed by Airways Company A ('Company A') as a pilot. At all relevant times, the Appellant was entitled to 'Accommodation and Rental Assistance' in accordance with Company A's conditions of employment, as amended from time to time.

(2) On 9 September 1996, the Appellant informed Company A that the monthly rent in respect of his residence, the yacht 'Yacht B', was increased to $53,000 for the lease period from 1 July 1996 to 30 June 1998. He requested Company A:

'to revise the rental payment at $53,000 per month to my Landlord with effect from 1st October 96.'

(3) Company C owned Yacht B. At all relevant times, the Appellant was a director of Company C.

(4) The Housing Policy Handbook issued by Company A in April 1998 contains, among other things, the following clauses in respect of housing benefit:

(2) Rental Assistance

(a) 'Employees with total rent equal to or below $24,000 per month will be entitled to receive the base rate of $24,000 per month.'

(b) 'Employees who do not have a rental contract will receive a basic payment of $24,000 per month. They will not be held accountable

for this amount'.

(c) 'Employees with actual total rent between $24,000 and $43,500 per month [the ceiling of $43,500 was subsequently adjusted to $38,000 for the period from 1 November 2000 to 31 October 2001 and to $40,500 from 1 November 2001], will be provided with full reimbursement of the actual total rent paid on production of a completed tenancy agreement.'

(d) 'An employee may choose either level 1 [$64,000 per month] or level 2 [$65,500 per month] ceilings from the date of next lease renewal or new lease created and at any subsequent lease renewal or new lease.'

…

(f) 'If an employee chooses level 1 his / her contribution will be 8% of the actual total rental up to a maximum of $64,000 per month.'

(g) 'If an employee chooses level 2 his / her contribution will be 12% of the actual total rental up to a maximum of $65,500 per month.'

(3) For House/Boat Owner Occupiers

(a) 'Rental Assistance will be based on the actual monthly mortgage payment of the boat or the house upon joining this scheme subject to a maximum amount equivalent to the Rent Free Zone which is currently fixed at $43,500 per month. The allowance so determined shall remain unchanged for a period of 2 years. At the end of the 2 year period, the allowance payable shall be reviewed according to the mortgage payment prevailing at the time, subject to the limit of the applicable Rent Free Zone. In the same manner, the reviewed allowance shall remain unchanged for the next two years.'

(b) 'Owner occupiers shall receive a fixed rental assistance equal to the base rate prevailing at the time, currently $24,000 per month at the end of the mortgage term or a cumulative total of 15 years as an owner occupier, whichever is sooner. ...

The monthly rental assistance shall not be less than the base rate, currently $24,000 even when the monthly mortgage payment is less than this amount. …'

(c) 'A receipt of the actual purchase price of the boat / house shall be produced at the time of application of rental assistance, and should the boat / house be purchased through a service company proof of ownership of the company shall be provided at the same time. …'

(5) On behalf of its members, including the Appellant, the Hong Kong Aircrew Officers Association entered into an 'Accommodation and Rental Assistance Policy Agreement' with Company A on 2 July 1999. The Agreement contains, amongst others, the following clauses for home and boat owner / occupiers:

5.1 '[Company A] will provide Officers with assistance to acquire a house or boat in Hong Kong for the sole purpose of use as their family residence.'

5.2 'The assistance, in the form of a cash allowance, is based on the actual monthly mortgage payment of the house or boat. The maximum amount available is equivalent to the Rent Free Zone [$39,500; the Rent Free Zone was subsequently adjusted to $38,000 for the period from 1 November 2000 to 31 October 2001 and to $40,500 from 1 November 2001 onwards]. The allowance so determined will remain unchanged for a period of two (2) years.'

5.3 'At the end of the two (2) year period, the allowance payable will be reviewed according to the mortgage payment prevailing at the time; subject to the limit of the applicable Rent Free Zone. In the same manner, the reviewed allowance will remain unchanged for the next two (2) years.'

5.4 'The monthly rental assistance will not be less than the Base Rate Level [$24,000] even when the monthly mortgage payment is less than this amount.'

5.5 'At the end of the mortgage term, or a cumulative total of fifteen (15) years as an owner occupier, whichever is sooner, Officers will receive a fixed rental assistance equal to the Base Rate Level prevailing at the time. The 15 year period will count from the date that the Officer first became an owner occupier.'

5.6 'Officers are obliged to inform Housing Services Section immediately should there be any change in ownership of the house or boat.'

5.7 'A receipt for the actual purchase price of the house / boat will be produced at the time of joining the scheme. Should the house / boat be purchased through a service company, proof of ownership of the company

must be produced at the same time. In addition, financing arrangements and any other relevant documents, as required by [Company A], must be produced at the start of the scheme and at review periods.'

(6) (a) On 19 March 2001, Company A informed all its non-local employees, including the Appellant, in receipt of housing assistance of the following background and changes in tax reporting for owner occupiers:

(i) 'Background

The [Company A] Owner Occupier scheme provides for Housing Assistance payments based on the actual monthly mortgage payment for the house or boat up to the applicable Rent Free Zone (RFZ) allowance. Such Housing Assistance will be paid for a cumulative period of 15 years or until the end of the mortgage term, whichever is sooner, after which the amount of Housing Assistance reduces to the "basic" allowance applicable at the time.

The IRD requires that all such applications need to be properly declared.'

(ii) 'The Changes in Tax Reporting by the Company

In summary, in order to comply with IRD requirements, with effect from 1st April 2001, the housing allowance payable to employees who are Owner Occupiers, irrespective of whether they have service companies or not, will be reported by the company as a "cash" allowance and will therefore be fully taxable.

These changes apply equally to Owner Occupiers who are receiving a monthly benefit based on actual mortgage payments and those Owner Occupiers receiving the "basic" allowance.'

(b) In its 'Housing Benefit Policy – Clarification' dated 19 March 2001 which was distributed to relevant employees, including the Appellant, Company A explained, amongst other things, that:

'5. An employee may not claim rental assistance (as opposed to financial assistance if the employee is a house / boat Owner Occupier) in respect of leased accommodation owned by himself, his spouse and / or a relative of either himself or his spouse, or in which he, his spouse or any relative of himself or his spouse has an interest. ... An

"interest" is defined as (a) a beneficial interest under a trust; or (b) a direct or indirect interest in; or (c) being a director or shareholder of a company (other than a company the shares of which are quoted at The Hong Kong Stock Exchange) which (i) is the registered proprietor of the leased accommodation; ...'

(7) (a) By an application dated 21 December 2001, the Appellant applied for housing assistance under Company A's Owner Occupiers Housing Assistance Scheme in respect of the yacht, 'Yacht D', located at Berth E, Address F. This document was sent to the 'Personnel Department (Housing Services)' and headed 'Housing Assistance Application Form for Owner Occupier'. In it the Appellant, and not Company C, stated that 'I wish to apply for housing assistance under the Owner Occupiers Housing Assistance Scheme' and 'This is to inform you that I have purchased the premises / boat as my residence'. In the application form, the Appellant declared that the owner occupier effective date was 1 January 2002. The purchase price of the boat was $6,050,100. To finance the acquisition of the boat, the Appellant obtained a mortgage loan of $1,950,000 from Bank G which was to be repaid by 60 monthly instalments of $40,500 each. The application form contained the following note:

'The aggregate allowance payable to you by [Company A], over a period of 2 years, shall under no circumstances, exceed the actual loan payment(s).'

(b) On 21 December 2001, the Appellant wrote to Company A stating: 'I hereby give [Company A] the authority to deduct $53,000 from my salary directly into [Company C] Bank details as per your records.'

(8) In its 2001/02 Employer's Return filed in respect of the Appellant, Company A declared the following particulars of the Appellant's income:

Salary	$1,228,437
Education benefit	70,500
Allowance	347,468
	$1,646,405

The Employer's Return stated that the Appellant's residential address was at Berth E, 'Yacht D', Address F.

(9) Company C was the registered owner of 'Yacht D'.

(10) The Appellant declared the following particulars of income in his 2001/02 tax return:

Income	:	$1,308,904
Address of quarters	:	Address F
Rent paid by him to landlord	:	$636,000
Rent refunded to him by Cathay	:	$337,500

(11) In the salaries tax assessment raised on the Appellant for 2001/02, the assessor included in his assessable income the amount described in fact 10 as 'Rent refunded to him by [Company A] – $337,500'. The Appellant objected to this assessment on the ground that the rental reimbursement made to him by Company A should not be assessed in full.

(12) To support his objection, the Appellant put forward the following contentions:

(a) 'The fact that [Company A] considers that the allowance should be declared as a cash allowance for their accounting purposes does not imply that I am not using the allowance as money to pay my rent. My Conditions of Service with [Company A] state that [Company A] will provide accommodation and rental assistance ...'

(b) 'As I have stated before the fact that [Company A] no longer requires each employee to provide a tenancy agreement, does not mean that I do not have a tenancy agreement. For me to receive the allowance from [Company A], I was required to submit a tenancy agreement, which was adjudicated by your offices on the 19 September 1996.[1] This Tenancy agreement is for $53,000. The agreement is still in force and the aforesaid amount of money deducted from my salary by [Company A] for payment *directly into my Landlord's account* has not changed. I have included copies of payment advices from [Company A] indicating that they have paid my Landlord ([Company C]) the sum of $53,000. This is sufficient evidence to prove that I am not spending the so-called cash allowance in any other way, other than for the sole purpose of paying rent. [Company A] is paying the sum of $53,000 directly into the bank account of my Landlord, [Company C]. These funds are not spent, as I feel fit, they are used solely for rent.'

[1] We have seen a copy of this stamped lease agreement, dated 18 September 1996, between Company C as landlord and the Appellant as lessee of the yacht Yacht B. It provided for a lease for two years, ' with the right of renewal subject to negotiation' , at a monthly rent of $53,000. In his notice of appeal the Appellant claims that the right of renewal was instituted. We have also seen a copy of a second stamped lease, dated 15 February 2002, between Company C as landlord and the Appellant as lessee. It provided for a lease of the Yacht D for two years commencing on 1 January 2002 at the same monthly rent of $53,000.

(c) 'I would like to draw your attention again to the wording on my salary slips, Rental subsidy, advance rent deduction, and housing assistance. The money is *deducted from my salary for the sole purpose of paying rent* to my landlord...' (*emphasis as per original*)

(13) In response to the assessor's enquiries, Company A provided the following information:

(a) From 1 April 2001 onwards, Company A no longer required the Appellant to provide tenancy agreement and rental receipts for scrutiny before allowing him to receive the assistance of $24,000 a month, from 1 April to 31 December 2001 and $40,500 a month, from 1 January to 31 March 2002.

(b) 'According to the [Accommodation and Rental Assistance Policy Agreement – fact 5 refers] [the Appellant] was still eligible to the housing assistance for owner-occupier where his residence was owned by a limited company controlled by him. From 1 April 2001 to date, he has not been eligible to the rental assistance for leaseholder.'

(c) 'Please note that [the Appellant's] housing benefit was governed by [Company A's] housing benefit policies prevailing at the time of application and any subsequent changes thereafter.'

(d) A breakdown of the allowance reported at fact 8 was as follows:

	Period	**Amount**
Leave passage	1-4-2001 to 31-3-2002	$9,968
Rental assistance	1-4-2001 to 31-12-2001	[$24,000 x 9] = $216,000
	1-1-2002 to 31-3-2002	[$40,500 x 3] = $121,500
		$347,468

(14) In its 2002/03 employer's return filed in respect of the Appellant, Company A declared the following particulars of his income:

Salary	$1,265,819
Bonus	175,500
Allowance	523,929
	$1,965,248

(15) The Appellant declared in his 2002/03 tax return that he derived income of $1,479,248 from Company A. He also declared that he paid rent of $636,000 ($53,000 x 12) to the landlord of his residence of which he obtained refund of $486,000 ($40,500 x 12) from Company A.

(16) In the salaries tax assessment raised on the Appellant for 2002/03, the assessor included as part of the assessable income the amount described in fact 15 as refund of rent of $486,000. The Appellant objected to this assessment on the ground that the rental reimbursement made to him by Company A should not be assessed in full.

(17) At all relevant times, the Appellant's payroll slips prepared by Company A showed a debit item for 'Advance Rent Deduction' of $53,000 per month. Company A advised the assessor that this 'is the rent payment made to the landlord by [Company A] with direct bank transfer'. The payroll slips also showed (1) for the period April and May 2001 a credit item for 'Rental Subsidy' of $24,000 per month and (2) for the period June 2001 to March 2003 inclusive a credit item for 'Housing Assistance' of $24,000 per month up to and including December 2001 and $40,500 per month thereafter. Company A advised the assessor that this 'is the cash allowance for housing [for] which [the Appellant] is entitled'.

The representatives

3. At the hearing before us the Appellant was represented by his colleague, Mr H. The Commissioner was represented by the assessor, Mr Yeung Siu-fai.

Statutory provisions and authorities

4. The parties referred us to the following provisions of the Inland Revenue Ordinance ('IRO'): sections 8(1), 9(1), 9(1A), 9(2), 11D(a) and 68(4).

5. Section 8(1), the basic charging section for salaries tax, provides that salaries tax shall be charged on income from employment. Income from employment is defined in section 9(1). The definition, which is not exhaustive, provides:

'9(1) Income from any office or employment includes –

(a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others,

> *(b) the rental value of any place of residence provided rent-free by the employer ….*
>
> *(c) where a place of residence is provided by an employer … at a rent less than the rental value, the excess of rental value over such rent …'*

6. A place of residence shall be deemed to be provided by the employer for a rent equal to the difference between the rent payable or paid by the employee and the part thereof paid or refunded by the employer and such payment or refund shall be deemed not to be income. Specifically, section 9(1A) stipulates that:

> *'(a) Notwithstanding subsection (1)(a), where an employer …*
>
> *(i) pays all or part of the rent payable by the employee; or*
>
> *(ii) refunds all or part of the rent paid by the employee,*
>
> *such payment or refund shall be deemed not to be income;*
>
> …
>
> *(c) a place of residence in respect of which an employer … has paid or refunded part of the rent therefor shall be deemed for the purposes of subsection (1) to be provided by the employer … for a rent equal to the difference between the rent payable or paid by the employee and the part thereof paid or refunded by the employer …'*

7. Section 9(2) provides that the rental value of any place of residence shall be deemed to be 10% of the income as described in section 9(1)(a) after deducting certain outgoings and expenses.

8. Mr Yeung also referred us to the following cases and derived the following propositions therefrom:

> CIR v Page (2002) 5 HKTC 683: the real test to determine whether a payment was a rental refund is to ascertain the intention of the parties as at the time of the payment by the employer; and
>
> D8/82, IRBRD, vol 2, 8: splitting a taxpayer's remuneration into salary and housing allowance does not necessarily render the portion labelled housing allowance as exempt income. It is up to the taxpayer to prove that the sum claimed as a housing

allowance is a rent refund.

The case for the Appellant

9. At the hearing before us, Mr H accepted that the Accommodation and Rental Assistance Policy Agreement (fact 5 refers) was legally binding on both the Appellant and Company A.[2] He directed our attention to the fact that it distinguished between two groups, namely, leaseholders and owner occupiers. Within this distinction Mr H noted that there was another important dichotomy, namely, those receiving assistance who provided Company A with documentation and those receiving assistance who did not provide Company A with documentation.

10. Where a leaseholder or owner occupier provided no documentation, that employee would only be entitled to a monthly base allowance of $24,000. Mr H accepted that an employee in this category simply received a cash allowance that was taxable since its use was uncontrolled. However, where a leaseholder or owner occupier provided documentation to Company A, the scheme provides for a payment of no less than the monthly base rate of $24,000 up to a maximum specified amount. This category applied to the Appellant, who received rental refund or reimbursement, as distinct from a cash allowance, since its use was obviously controlled because it was paid upon the production of documents.

11. Mr H reminded us that at all relevant times, and in accordance with Company A's housing scheme, the Appellant had leased a vessel from Company C (first Yacht B and then Yacht D) and in both cases the Appellant had sent to Company A at the commencement of the lease a properly executed lease adjudicated by the Stamp Office.[3] He also reminded us that, at all relevant times, the Appellant had a liability to pay rent to Company C and that Company A had directly handled the payments of rent made to Company C and this is evidenced by the Appellant's payroll slips which showed payments of 'Advance Rent Deduction' in the amount of $53,000 per month.

12. Mr H argued that, following Company A's memorandum of 19 March 2001 (fact 6 refers), Company A simply treated the Appellant as an owner occupier for its own administrative purposes in reporting Company A's housing assistance to the Inland Revenue Department and this was not justified since there had been no change to the Accommodation and Rental Assistance Policy Agreement.

13. Mr H stated it was significant that, as a result of Company A's change in reporting to the IRD as set out in its memorandum of 19 March 2001, Company A required current housing

[2] By way of contrast, Mr H contended that Company A's handbook (fact 6 refers), which was headed 'Housing Benefit Policy', was merely for general guidance and information. This handbook was produced for the benefit of both Company A's housing service administrators and eligible employees and showed how Company A's housing scheme worked. This handbook and Company A's memorandum referring to it did not, in Mr H's view, alter the scheme; it simply changed Company A's reporting to the IRD in relation to the scheme.

[3] See note 1 above.

documents to be submitted to it and gave employees until the end of the financial year 31 March 2002 to comply. In the event, the Appellant did comply and he supplied those documents to Company A on 21 December 2001 (fact 7 refers) when he applied for housing assistance under the owner occupier scheme to lease the new vessel, Yacht D.

14. Finally, Mr H argued that, at all relevant times, Company A's intent was to reimburse the Appellant for his rental liability to Company C and this was evidenced by robust controls and record-keeping requirements adhered to by Company A in its establishment and administration of the Housing Assistance Scheme.

The case for the Commissioner

15. Mr Yeung's basic argument was simply put – at the time of the payment of the amounts in dispute Company A's intention was not to pay a rental refund to the Appellant. Instead, Company A's intention at the time was to pay the Appellant, an owner occupier, financial assistance to subsidize his mortgage payments. In Mr Yeung's submission, these were cash allowances fully taxable under section 9(1)(a).

Analysis

Argument under section 9(1A)(a)(ii)

16. The first issue for our decision is whether the sums of $337,500 and $486,000 paid by Company A to the Appellant for the years of assessment 2001/02 and 2002/03 are allowances chargeable to salaries tax in terms of section 9(1)(a) or refunds of rent within the meaning of section 9(1A)(a)(ii). In the former case, the sums should be assessed in full. In the latter case, the Appellant should be assessed only on the rental value of the place of residence provided to him by Company A in accordance with sections 9(1)(c), 9(1A)(c) and 9(2).

17. It is common ground that under the Accommodation and Rental Assistance Policy Agreement (fact 5 refers) Company A's policy was to provide a housing benefit to eligible employees by way of refunding amounts paid by them for accommodation. Such provision could be by way of refund of rent or by way of refund of mortgage payments, in both cases capped at a maximum monthly amount.

18. It is also common ground that in accordance with Page's case, a decision of the Court of First Instance which is binding upon us, the test to determine whether a payment was a rental refund is to ascertain the intention of the parties as at the time of the payment by the employer. In this regard, Mr H repeatedly drew our attention to the document extracted at fact 6. He submitted that Company A's intention at the time of payment is most clearly evidenced by the following statement in that document:[4]

[4] See Bundle R1, page 127.

> ' All forms of housing benefits provided by [Company A] to eligible employees are governed by the principal of reimbursement for actual rent paid *or* mortgage payments made, up to allowable limits, and the live-in requirement as set out below, except for employees who do not submit a valid lease agreement and only claim the "basic allowance".' (emphasis added)

19. Thus, the question remains – were the sums in dispute rental assistance (in the form of rental refund) or payments to acquire a boat for use as a family residence (based on the actual mortgage payment)? At the hearing we put this question directly to Mr H. His reply was:

> The Appellant in receiving assistance cannot dispose of the assistance in any way he thinks fit. In fact, [Company A] provides accommodation for employees as a contractual entitlement. The Appellant could only dispose of the assistance for bona fide accommodation. His entitlement was contractual – there is no possibility of him receiving assistance over and beyond his housing requirement and the assistance cannot exceed the maximum of the level of assistance which is determined by the level of accommodation occupied by the Appellant.
>
> I agree that this is a benefit of his employment but it is not disposable income that can be applied in any manner that he wishes. It should only be assessed as an accommodation benefit and not as a cash allowance.

20. With respect, this response begs the question. For the purposes of argument, we accept that the Appellant could not receive rental or housing assistance in an amount above his housing requirement and, again for the purposes of argument, we accept that the Appellant received the amounts in dispute for housing purposes.[5] We also find that the documents placed before us indicate that the administration of Company A's housing assistance scheme was buttressed, where relevant, by some controls and record-keeping requirements. But the sum of these statements still does not tell us in which category under that scheme – rental refund or payments for mortgage assistance – these amounts should fall.

21. In our view, however, the answer is very clear. The facts found show that Company

[5] These assumptions are not entirely accurate since both the documents extracted at facts 4 and 5 provide that the Appellant would be entitled to receive the 'Base Rate' of $24,000 per month regardless of his cost of housing, and regardless of whether this took the form of rent or mortgage payment. In this regard, there is no evidence before us as to the extent (if any) of mortgage payments made for the period April – December 2001 to finance the purchase of the vessel Yacht B. We also note the generic use of the phrase 'rental assistance' in parts of those documents, and this was applied imprecisely to *all* owner occupiers who were entitled to housing assistance for their mortgage payments. Indeed, the Appellant's notice of appeal arguably reflects this problematic nomenclature, where it is stated, without explanation, that he received 'rental assistance' and not 'financial assistance'. This confusion was however rectified in the Housing Benefit Policy extracted at fact 6, where a clear distinction is made between 'rental assistance' for leaseholders and 'financial assistance' for owner occupiers. See also the penultimate sentence of fact 17.

A' s intention throughout the years of assessment 2001/02 and 2002/03 was for it to pay and for the Appellant to receive housing assistance to acquire a boat (albeit through a service company) and not as rental refund. This conclusion is best illustrated by considering, as we must, the nature of that assistance for two distinct periods, namely, from April 2001 – December 2001 inclusive (when the Appellant was paid the monthly Base Rate of $24,000) and from January 2002 – March 2003 inclusive (when the Appellant applied for and received the higher monthly amount of $40,500).

The period April 2001 – December 2001 inclusive

22. There are several reasons why the amounts in dispute paid in this period should not be treated as rental refunds. As Mr Yeung contended in his written submission:

> ' In March 2001 [Company A] notified its employees that an employee could not claim rental assistance in respect of leased property in which he had an interest [fact 6 refers]. Hence, it is clear that from the year of assessment 2001/02 onwards, [Company A] will only provide financial assistance but not rental assistance to its employee who occupied his own boat or property. The sums in question are thus not rent refunds but cash allowances to subsidize the Appellant' s mortgage payments.'

23. This notification by Company A to the Appellant is not, as Mr H contended, simply stating a change in reporting for tax purposes. It was a clear and categorical statement that from April 2001 onwards Company A will not pay rental assistance for accommodation in which the Appellant had a direct or indirect interest (through a service company) as an owner occupier. Subsequently, Company A adhered closely to this statement as evidenced by its payroll slips for the Appellant, as well as by its unambiguous communications with the assessor (fact 13 refers).

24. Perhaps most strikingly however, the amount of the monthly housing assistance for the period April 2001 to December 2001 was set at the Base Rate of $24,000 (fact 13(a) and (d) refers). This is in accordance with clauses 5.4 and 5.5 of the Accommodation and Rental Assistance Policy Agreement, presumably because the mortgage term of the loan to acquire Yacht B had expired.[6] If, contrary to this conclusion, the Appellant had received a rent refund, the Agreement specifically states in clause 4.2.c.iii that Company A will pay 92% of the actual cost of accommodation for eligible employees whose rent is above the Rent Free Zone but at or below $63,000 per month. At all relevant times, the Appellant' s liability to pay rent to Company C stood at $53,000 per month and Mr H contends that Company A was aware of this fact. Thus, if the Appellant were, as he claims, entitled to a rental subsidy as an eligible employee providing documentation to Company A, under the Agreement the terms of that subsidy would not, and could not, be restricted to $24,000 per month.

[6] Compare the statement to that effect in the Appellant' s notice of appeal.

25. If, contrary to our conclusion, the housing assistance were restricted to $24,000 per month because, contrary to the Appellant's argument, he chose not to provide documents to Company A (see clause 4.2.a.ii of the Agreement), then Mr H accepts that the relevant amounts should be treated as taxable cash allowances. In this event, not only could the Appellant spend the amounts as he wished, but he would also be entitled to receive them regardless of his housing needs.

The period January 2002 – March 2003 inclusive

26. The answer for this period is even clearer. When the Appellant received the increased monthly housing benefit of $40,500 with effect from January 2002, this was not paid pursuant to any claim made to Company A for rental assistance. Rather, as shown clearly by fact 7, the Appellant made a claim as owner occupier for housing assistance to acquire – and not lease – a residence.

27. If the Appellant wished to apply for rental assistance in respect of a leased property, which we reiterate was not allowed by Company A after March 2001 (because he had an interest in the leased accommodation, being a director of his corporate landlord), the documents before us indicate that he would need to submit his request to Company A by way of a 'Rental Assistance Application Form'. Not only is there no evidence before us that the Appellant submitted this Form to Company A, but his application set out at Fact 7 stated unequivocally:

> 'I confirm that I wish to be included in this Scheme [the Housing Assistance Scheme for Owner Occupier] ...'

28. Before concluding, we reject the statement made in Appellant's right of reply that he only received the amounts in dispute because of his liability for 'rent payable'. In our view he received the amounts, in accordance with Company A's housing assistance scheme, as an owner occupier for the purpose of acquiring a residence. The fact that he paid rent to Company C under a stamped lease produced to Company A does not alter this conclusion. The payment deducted from his salary by Company A was an application of funds after his entitlement to housing assistance as an owner occupier had been determined and separately paid.

Conclusion on section 9(1A)(a)(ii)

29. We have no doubt that, at all relevant times after 1 April 2001, the intention of the parties when the amounts in dispute were paid was for Company A to pay to the Appellant assistance to acquire a residence through his service company, Company C, by helping finance the costs of the relevant mortgage. This is clearly evidenced by the statements and acts of Company A, including the monthly cap on that assistance by reference to the Base Rate of $24,000 (until January 2002) and then by reference to the actual monthly mortgage payment of $40,500 for the yacht Yacht D, instead of by reference to the monthly rental payment to Company C of $53,000. All this

was accepted apparently without demur by the Appellant, and is entirely consistent with the Appellant's actions described at fact 7. We conclude that Company A at all relevant times provided cash allowances to the Appellant which are subject to salaries tax under section 9(1)(a); they were not refunds of rent for the purposes of sections 9(1)(c), 9(1A)(c) and 9(1A)(a)(ii).

Argument under section 9(1A)(a)(i)

30. During the hearing the question was raised whether the amounts in dispute were exempt under section 9(1A)(a)(i). This provision states:

> *'(a) Notwithstanding subsection (1)(a), where an employer …*
>
> *(i) pays all or part of the rent payable by the employee;*
>
> *…*
>
> *such payment … shall be deemed not to be income'.*

31. In his right of reply Mr H contended that the Appellant had incurred an actual documented liability to pay rent of $53,000 per month and Company A, by paying the landlord direct (on the Appellant's authority to deduct this amount from his salary), met that liability. In these circumstances, Mr H submitted that section 9(1A)(a)(i) was satisfied and the amounts in dispute should be exempt from salaries tax.

32. On the other hand, Mr Yeung contended that section 9(1A)(a)(i) could only apply to the Appellant's case if Company A's intention in paying the sum of $53,000 per month was to provide this amount as a housing benefit as part of the Appellant's contractual entitlement. In other words, such sums could only be exempt if paid to the Appellant *in addition* to the contracted salary and housing assistance. Mr Yeung argued that this was not the case here since the amounts were simply paid by Company A to Company C (and labeled as 'Advance Rent Deduction') from salary which had already been accrued and deemed to have been received under section 11D(a). In short, he argued that these payments had nothing to do with Company A's housing benefit scheme.

Majority view

33. Before commencing our analysis, we must state that, in our view, Mr Yeung's reliance on section 11D(a) is misplaced. The issue is not whether the Appellant's salary had accrued (it did); rather, the issue is whether section 9(1A)(a)(i) applies to exempt amounts that would otherwise be chargeable to salaries tax.

34. Notwithstanding our initial attraction for the proposition that the Appellant's case falls within the literal wording of section 9(1A)(a)(i), on reflection we cannot conclude under those statutory terms that Company A 'pays the rent payable by [the Appellant]'. Company A did not

pay any rent – it just transferred money into Company C's bank account, by way of a payroll deduction from the Appellant's contractual salary, at the Appellant's direction. However one looks at it, the Appellant paid the rent for which he was liable. Company A simply acted as a conduit for that payment.

35. If, contrary to our conclusion, we accepted that Company A paid the rent payable by the Appellant, it must follow that any person liable to salaries tax could secure the tax-advantaged treatment available for employer assisted rental benefits through the simple expedient of arranging a direct debit from his or her salary by the employer to the landlord in an amount equal to the total rent payable. We do not, however, base our decision on this ground and note that there was no argument before us concerning the legislative intent. Notwithstanding the above comments, we cannot see how section 9(1A)(a)(i) could apply in the absence of a contractual commitment by the employer to provide a rental benefit for the employee or, at least, clear evidence that in addition to the employee's other remuneration the employer intended to discharge the employee's liability to pay rent as consideration for the services rendered under the employment. Neither of these conditions is satisfied in the present case.

36. In this regard, and for the sake of completeness, we must add that we cannot conclude that the terms of the Appellant's contract of employment were varied so that Company A was bound to pay the rent payable by the Appellant. As stated earlier in this decision, the payment deducted from his salary by Company A was an application of his remuneration after his entitlement to housing assistance as an owner occupier had been determined and separately credited to his payroll. We appreciate that the Appellant's payroll slips refer to 'Advance Rent Deduction'. However, as a matter of fact Company A did not during the relevant period require or ask for the lease agreement (fact 13(a) refers); and the Appellant's authorization to Company A (fact 7(b) refers) did not constitute any contractual entitlement binding Company A to pay the rent payable by the Appellant.

37. How then can section 9(1A)(a)(i) operate? The clearest example is where the contract of employment provides that the employer agrees to bear the cost of the employee's rent (typically up to a maximum amount) for premises leased by the employee. That payment may be (typically) part or (uncommonly) all of the employee's remuneration from the employment. But where, as in the Appellant's case, a basic salary as well as housing assistance for mortgage payments were agreed and credited in his payroll, a subsequent application of that salary cannot, in any legal or substantive way, be regarded as a payment by Company A of rent. This conclusion is supported by the Appellant's own tax returns where it is recorded that he paid rent to Company C. There is no suggestion therein that Company A paid any rent to Company C.

Dissenting view

38. We have reached a unanimous decision on all the above issues save and except the application of section 9(1A)(a)(i) on which Mr Ip has come to a different conclusion. His reasons for coming to a different conclusion are set out below.

39. As above noted, the direct payments made by Company A of the monthly rent of $53,000 payable by the Appellant to Company C under the two leases respectively dated 18 September 1996 and 15 February 2002 appear to fall within the literal meaning of the provision in section 9(1A)(a)(i). Is such interpretation fair, large and liberal as will best ensure the attainment of the object of the Inland Revenue Ordinance according to its true intent, meaning and spirit (as stipulated in section 19 of the Interpretation and General Clauses Ordinance)?

40. The absence of any submission from the parties on the history of the enactments leading to the addition in 1954 and subsequent amendments in 1975 and 1991 of the provisions in section 9(1A) precludes any assistance to be derived from such information in trying to ascertain the true intent of the provision in question. Nevertheless, the following is reasonably clear from the provisions themselves:

(1) Whilst such payment or refund made by an employer within the meaning of section 9(1A)(a) shall be deemed not to be income, it does not necessarily follow that such payment or refund is exempt from salaries tax.

(2) In fact, the employee will effectively be taxed for such payment or refund on the basis that such payment or refund is deemed to be equivalent to 10% of the income derived from the employer or others as described in section 9(1)(a).

(3) In other words, such payment or refund is exempt from salaries tax only if the employee derives no other income from the employer or others as described in section 9(1)(a).

(4) For an employee with a very high salary such that 10% of his salary far exceeds the amount of rent paid or refunded by the employer, the operation of section 9(1A) will in fact work to the employee's disadvantage. In such a case, the employee will no doubt avoid the operation of section 9(1A). Alternatively he may seek to rely on proviso (b) in section 9(2) allowing him to elect to use the rateable value of the place of residence should it be more advantageous to him.

(5) There is no express requirement that a place of residence provided or deemed to be provided rent free by the employer as referred to in section 9 has to be the employee's own place of residence. On the contrary, the definition of *'place of residence'* in section 9(6) that it *includes* a residence provided by an employer *notwithstanding* that the employee is required to occupy that place of residence by or under his terms of employment suggests that the application of section 9(1A) is not confined to such payment or refund of rent payable or paid by the employee for his own place of residence.

41. The various contentions against the application of section 9(1A)(a)(i) to the facts of the present case are then considered in the light of the above observation.

42. Firstly, Mr Yeung sought to rely on the proviso in section 11D(a) which states:

'For the purpose of section 11B -

(a) income which has accrued to a person during the basis period for a year of assessment but which has not been received by him in such basis period shall not be included in his assessable income for that year of assessment until such time as he shall have received such income, when notwithstanding anything contained in this Ordinance, an additional assessment shall be raised in respect of such income:

Provided that for the purposes of this paragraph income which has either been made available to the person to whom it has accrued or has been dealt with on his behalf or according to his directions shall be deemed to have been received by such person.'

43. Based on this proviso, Mr Yeung submitted that the Appellant's gross monthly basic salary was deemed to have been received by him despite the deduction from such basic salary for the payment of rent made by Company A upon the Appellant's direction.

44. Mr Yeung's submission is no doubt correct if Company A made payments for other expenses incurred by the Appellant upon the Appellant's direction. However, Mr Ip is unable to see how sections 11B and 11D could have operated so as to reverse the deeming provision in section 9(1A)(a) such that the employer's payment or refund of rent payable or paid by the employee could be deemed to be income received by the employee.

45. Secondly, Mr Yeung gave an example of a taxpayer directing his employer to pay his salary in full to his landlord as rent and asked the question: is it right to say that he had no assessable income? If the transaction is not artificial or fictitious and if the employer did act upon the employee's direction and pay rent to the landlord and nothing else to the employee, Mr Ip can see no compelling reason why a negative answer must be given to the question posed by Mr Yeung. If the legislature had intended that the operation of the 10% rule must not result in nil assessable income for an employee receiving only the benefit of a rent free place of residence provided or deemed to have been provided by the employer, surely the legislature would have made appropriate provisions to deal with such a situation. In the absence of such statutory provision, the mere fact that the application of section 9(1A)(a)(i) will result in nil assessable income to the employee should not be a valid ground for not applying section 9(1A)(a)(i) in accordance with its terms.

46. Thirdly, Mr Yeung suggested that section 9(1A)(a) is only applicable to those cases where the employer, apart from paying the employee monthly basic salary, also paid the rent payable by the employee or refunded the rent paid by the employee. According to this suggestion, for an employee already paying rent at the time of entering into the employment contract such that his payroll slip shows a basic salary of $50,000 plus rent payment of $50,000 to the landlord, his assessable income will be $55,000. However, for another employee who only secured the lease after he had entered into the employment contract such that the entries in his payroll slip may consist of a basic salary of $100,000 less a deduction of $50,000 for rent payment made to his landlord, according to Mr Yeung's suggestion, his assessable income will be $100,000. Such anomalous result in tax treatment in two situations which have no difference in substance shows only too clearly that the suggested narrow interpretation of section 9(1A)(a) as advocated by Mr Yeung is unacceptable.

47. Mr Yeung's suggestion is perhaps derived from the not uncommon perception that section 9(1A)(a) normally deals with housing benefit in the form of rent payment or refund made by the employer in addition to the employee's other emoluments unaffected by whether or not the employee claims such housing benefit. In other words, because the provision normally deals with such situations, its application should also be confined to such situations. Such deduction is of course illogical and in a case where an employee has been enjoying housing benefit in the form of rental payment to which section 9(1A)(a)(i) applies, the fact that such housing benefit is subsequently withdrawn does not mean that section 9(1A)(a)(i) must also cease to apply. As long as the employer continues to make payment of rent payable by the employee, albeit with a corresponding deduction from the employee's other emoluments, there is no reason why section 9(1A)(a)(i) should not continue to apply.

48. Fourthly, as to the view taken by the majority that for section 9(1A)(a)(i) to operate, there must be the existence of a contractual commitment by the employer to provide a rental benefit for the employee, Mr Ip's answer to this is two-fold:

(1) In construing the meaning of *'income from any office or employment'* as described in section 9(1)(a), presumably one will not accept any limitation of its scope so as to extend only to the amount paid by the employer pursuant to a commitment provided in the employment contract. Thus, a bonus paid by the employer will presumably be caught by section 9(1)(a) even if the employment contract does not provide for any entitlement to bonus. If so, why is it appropriate to adopt a more stringent standard in construing section 9(1A)(a) by limiting its operation to cases involving payment or refund of rent made by the employer pursuant to a contractual commitment provided in the employment contract?

(2) Further, as pointed out by the Court in CIR v Page, supra, the parties may by their conduct vary the terms of the employment contract. Even if the parties do

not by their conduct vary the terms of the employment contract, the parties' conduct may be such that the payment may be of a nature different from what is provided in the employment contract. The crucial question is the nature of the payment. In the present case, regardless of the terms of the Appellant's employment contract governing the Appellant's entitlement to housing benefit in different forms, the facts most relevant to this question about the nature of the payments made by Company A to Company C are as follows:

(i) On 9 September 1996, the Appellant informed Company A of the new lease term in respect of 'Yacht B' for the period from 1 July 1996 to 30 June 1998 and requested Company A to revise the rental payment at $53,000 per month to the Appellant's landlord with effect from 1 October 1996.

(ii) According to the lease dated 18 September 1996 produced by the Appellant which was duly stamped, the Appellant was liable to pay Company C $53,000 per month.

(iii) If Company A did act on the Appellant's request and paid the monthly rent of $53,000 to Company C, there seems little doubt that such payments should fall within section 9(1A)(a)(i). This is so whether or not a copy of the lease was provided to Company A which, if at all, might only affect the Appellant's claim for his housing benefit.

(iv) However, section 9(1A)(a)(i) might cease to apply to such further payments made by Company A to Company C after expiry of the lease on 30 June 1998 if the lease was not renewed by the Appellant. This is not due to any change in the nature of the payments made by Company A but rather the fact that one cannot be satisfied that the Appellant was liable to pay rent to Company C for the period in question.

(v) On 21 December 2001, the Appellant submitted his housing assistance application form for owner occupier and gave Company A the authority to deduct $53,000 from his salary. It is not clear why it was necessary for the Appellant to give such authority to Company A when, as shown in the available payroll slips for the period between April 2001 and November 2001, Company A had been making the deduction of $53,000 by way of 'Advance Rent Deduction'.

(vi) On 15 February 2002, the Appellant entered into another lease with Company C under which the Appellant was liable to pay rent at the same rate of $53,000. In the meantime, Company A had continued the

> payments to Company C and made the same 'Advance Rent Deductions' from the Appellant's emoluments. Although there is no evidence that the new lease was provided to Company A, it is clear that Company A had been acting on the Appellant's previous request to pay rent to the Appellant's landlord and thus in Company A's reply to IRD dated 25 September 2002, it was confirmed: 'Advance rent deduction is the rent payment made to the landlord by the Company with direct bank transfer'. When such payment clearly in the nature of rent payment made by Company A is coupled with the new lease produced by the Appellant proving that the Appellant was indeed liable to pay the rent in question, it is difficult to see why section 9(1A)(a)(i) should not apply to such rent payment. The fact that the Appellant was getting housing benefit in the form of assistance for mortgage payments rather than rental assistance should not alter the nature of such rent payment. Neither should it be altered by the manner in which the Appellant completed his tax returns stating that he paid the rent to Company C when the rent was in fact paid by Company A.

49. Lastly, to pay rent payable by the employee, the employer must invariably act in accordance with the employee's direction and in that sense he must act as a conduit for the employee. Mr Ip is therefore unable to agree with the conclusion drawn by the majority that Company A did not pay any rent since Company A simply acted as a conduit for the payments in question.

50. In summary, Mr Ip takes the view that any attempt to limit the operation of section 9(1A)(a)(i) to cases involving some kind of housing benefit in the form of rental payment is likely to be fraught with difficulties and a straightforward interpretation that it applies whenever the employer pays rent payable by the employee is to be preferred. Such interpretation is fair, large and liberal and the certainty of such interpretation will best ensure the attainment of the object of the IRO even if in particular cases, such as the present, such interpretation may not result in maximum recovery of revenue.

51. Given the Appellant's association with Company C, there may well be other provisions in the IRO which may be invoked to challenge the validity of the transaction involved. However, in the absence of any attempt on the part of IRD to do so, for the reasons above given, but for the decision reached by the majority, Mr Ip would have allowed the appeal and ordered a re-assessment in the following manner:

> (1) For year of assessment 2001/02, as noted above, the lease dated 18 September 1996 produced by the Appellant had long expired on 30 June 1998. Without any evidence of renewal produced by the Appellant, despite Company A's payroll slips, there is nothing to prove that the Appellant was in fact liable to

pay rent to Company C for the period between 1 April 2001 and 31 December 2001. However, the lease dated 15 February 2002 shows such liability for the remaining period. Therefore, section 9(1A)(a)(i) would only be applied to the payments of rent made by Company A for the period between 1 January 2002 and 31 March 2002.

(2) For year of assessment 2002/03, since the lease dated 15 February 2002 did not expire until 31 December 2004, section 9(1A)(a)(i) would be applied for the whole year of assessment.

Conclusion and order

52. On the facts found, and for the reasons expressed above, by majority decision we conclude that the sums in dispute were not exempt from salaries tax under either limb of section 9(1A)(a). The appeal is hereby dismissed.

53. It is left for us to thank both Mr H, who made a spirited defence for the Appellant, and Mr Yeung for their helpful submissions.