Case No. D30/04

Salaries tax – whether Revenue estopped from raising salaries tax assessments – whether payments made by employer constituted rental refunds – whether taxpayer intended to create a legally binding sub-tenancy agreement with a related company as landlord – whether letting arrangements constituted an artificial or fictitious transaction under section 61 of the Inland Revenue Ordinance ('IRO').

Panel: Ronny Wong Fook Hum SC (chairman), Alan Ng Man Sang and Anthony So Chun Kung.

Date of hearing: 5 June 2004.
Date of decision: 6 August 2004.

At all material times, the taxpayer and his wife were directors and the sole shareholders in Company B. The couple acquired a residential flat on 7 September 1991 and they subsequently arranged for the flat to be let to Company B and then sub-let to the taxpayer under a purported sub-tenancy arrangement. No written tenancy or sub-tenancy agreements existed between the relevant parties.

The taxpayer was employed by Company E from 1 April 1994 to 23 July 1994. During this period, Company E effected rental payments directly to Company B which was the landlord of the residential flat under the purported sub-tenancy arrangement.

Subsequently, between 1 August 1994 and the end of the year of assessment 2000/01, the taxpayer was employed by Company F. In this period, certain sums paid by Company F to the taxpayer were recorded as rental refunds. However, the taxpayer had never made actual payments of rent to Company B. Instead, the taxpayer claimed that the rent due from him to Company B was settled in the director's current account of Company B.

Originally, for the years of assessment 1994/95 to 1999/2000 the Revenue did not regard the housing assistance provided by Companies E and F as part of the taxpayer's taxable income. However, upon review, the Revenue sought to raise additional assessments for 1994/95 to 1999/2000 and an assessment for 2000/01 to include the housing assistance provided by Companies E and F.

The issue before the Board was whether the amounts allegedly paid as rent to the taxpayer's landlord constituted employment income chargeable to salaries tax. As a preliminary

matter, the Board considered whether the Revenue was estopped from raising the relevant assessments.

Held:

1. As a matter of general principle, the Revenue is usually not estopped from carrying out its statutory obligations. It cannot be prevented either by agreement or otherwise from discharging its duties under statute. The Revenue does not stand in the same position to the taxpayer as one party to a commercial transaction stands to another. But it did not follow that the Revenue could not in any circumstance be subject to an estoppel.

2. It was open for the Revenue to be estopped where the six criteria stated in D52/87 were present which pertained to the situation where the Revenue and the taxpayer reach a settlement on the basis of agreed facts which is decisive of both the quantum of tax paid and status of the taxable item in question that in turn founds the basis for a final and conclusive assessment under section 70 of the IRO.

3. These requirements were not satisfied since the Revenue did not unequivocally accept that the amount of housing assistance given by Company E and F were rental refunds and that the relationships between the relevant parties were genuine landlord and tenant relationships. Nor was there a settlement of the taxpayer's affairs after negotiation. It would unduly restrict the Revenue from carrying out its statutory obligations if the Revenue was estopped from raising assessments in the present case.

4. If a place of residence is not provided by the employer, the taxpayer must be able to show that the sum he has received which is claimed as a 'housing allowance' is a rental refund, either wholly or in part, which would entitle him to tax relief under section 9(1A) of the IRO. The ordinary meaning of 'refund' referred to a repayment or reimbursement by the employer and not a payment made without reference to whether a rental payment had already been made by the employee. The relevant point in time for analysis is when the monies were paid and not when the parties entered into the contract of employment.

5. On the facts, the taxpayer did not incur any rental expenses prior to his receipt of housing assistance from Company F. It followed that the sums received by the taxpayer did not constitute rental refund.

6. If there was no relationship of sub-tenancy between the taxpayer and Company B, the payments of housing assistance made by Company E and F would be treated

as cash allowances and taxable as employment income. On the evidence, the Board did not accept that the taxpayer and Company B intended to create a legally binding sub-tenancy agreement between them, and accordingly the housing assistance was taxable.

7. *Per curiam.* In any event, the Board would have considered that the letting arrangements were artificial and fictitious under section 61 of the IRO.

Appeal dismissed.

Cases referred to:

Extramoney Limited v Commissioner of Inland Revenue HKTC vol 4 394
D52/87, IRBRD, vol 2, 461
D8/82, IRBRD, vol 2, 8
D56/00, IRBRD, vol 15, 563
D19/95, IRBRD, vol 10, 157
D33/97, IRBRD, vol 12, 228
D21/98, IRBRD, vol 13, 203
Commissioner of Inland Revenue v Peter Leslie Page HKTC vol 5 683
D77/99, IRBRD, vol 14, 528

Yeung Siu Fai for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal by Mr A ('the Taxpayer') against the determination of the Commissioner of Inland Revenue dated 27 February 2004 ('the Determination') in respect of the additional salaries tax assessments for the years of assessment 1994/95, 1995/96, 1996/97, 1998/99 and 1999/2000 and the salaries tax assessment for the year of assessment 2000/01. The question at issue is whether the various amounts allegedly paid by the Taxpayer's former and present employers as rent to the Taxpayer's landlord were the Taxpayer's employment income chargeable to salaries tax. For convenience, we shall refer to those amounts collectively as 'the housing assistance' to avoid any legal implication which may arise from our adoption of the terms housing allowance or housing refund in this decision.

2. Although most of the documents submitted by the parties are in English, the hearing before us was in Cantonese at the behest of the Taxpayer.

Agreed facts

3. The facts as stated in paragraphs 1(1) to (19) of the Determination are agreed by both parties. Insofar as they are material, they are as follows:

(a) Company B was incorporated with limited liability in Hong Kong on 15 August 1986. At all material times, the Taxpayer and his wife (referred to hereinafter as 'the Couple' collectively) were Company B's only two shareholders. The directors of Company B have all along been the Couple and the parents of the Taxpayer.

(b) By an agreement for sale and purchase dated 13 August 1991, the Couple acquired the Property together with two carparking spaces at a consideration of $3,820,000. The conveyance was completed and the Property assigned to the Couple on 7 September 1991.

(c) To finance the purchase of the Property, the Couple obtained a loan of $2,865,000 from Finance Company C ('The FC Loan'). The FC Loan was secured by a mortgage on the Property.

(d) On 29 January 1997, the Couple obtained a loan of $8,900,000 from Bank D ('the Bank D Loan') by pledging the Property as security. Part of the Bank D Loan was used to repay fully the outstanding principal of $2,371,302.75 of the FC Loan.

(e) For the year of assessment 1994/95, the Taxpayer's former employer, Company E reported, inter alia, the following:

(i) that from 1 April 1994 to 23 July 1994, Company E employed the Taxpayer as manager and provided the Property to the Taxpayer as his quarter;

(ii) that from 1 April 1994 to 23 July 1994, the Taxpayer received a total basic salary of $19,416; and

(iii) that from 1 April 1994 to 23 July 1994, Company E paid a total rent of $192,000 to the landlord of the Property.

(f) For the years of assessment 1994/95 to 2000/01, the Taxpayer's present employer, Company F reported, inter alia, the following:

(i) that from 1 August 1994 to 31 March 2001, Company F employed the Taxpayer as manager and provided the Property to the Taxpayer as his quarter; and

(ii) that from 1 August 1994 to 31 March 2001, Company F refunded the rent paid by the Taxpayer to his landlord.

(g) In the 1994/95 to 1999/2000 Individuals Tax Returns, the Taxpayer declared the same employment income as declared by Company E and Company F. The Taxpayer also declared the following:

(i) Company E

	1994/95
Period provided	1-4-1994 – 23-7-1994
Rent paid by Company E to landlord	$192,000

(ii) Company F

	1994/95	**1995/96**	**1996/97**	**1997/98**	**1998/99**	**1999/2000**
Period Provided	1-8-1994 – 31-3-1995	1-4-1995 – 31-3-1996	1-4-1996 – 31-3-1997	1-4-1997 – 31-3-1998	1-4-1998 – 31-3-1999	1-4-1999 – 31-3-2000
	$	$	$	$	$	$
Rent paid by Taxpayer to	344,000	526,000	616,000	636,000	636,000	636,000
Rent refunded to Taxpayer by	344,000	526,000	616,000	636,000	636,000	636,000

(h) On the basis of the Individuals Tax Returns filed by the Taxpayer, the Revenue did not regard the housing assistance provided by Company E and Company F as part of the Taxpayer's taxable income, but charged the Taxpayer with 10% of his income as the deemed rental value of the Property provided rent-free by Company E and Company F for the years of assessment 1994/95 to 1999/2000. The Taxpayer did not raise any objection to these assessments.

(i) The accounts of Company B for the year ended 31 December 1994, 31 December 1995, 31 December 1996 and 31 December 1997 showed that its only source of income at the relevant times was rental income. No profits tax has been paid by Company B for any of the years of assessment from 1994/95 to 2000/01.

(j) On divers dates, the Couple submitted Property Tax Returns for the years of assessment 1994/95 to 1999/2000 in respect of the rental income allegedly received by them from the letting of the Property. On the basis of the Property Tax Returns filed, the Revenue raised on the Couple the following property tax assessments.

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000
	$	$	$	$	$	$
Assessable value per return	300,000	336,000	420,000	420,000	420,000	420,000
Less: 20% statutory allowance	60,000	67,200	84,000	84,000	84,000	84,000
Net assessable value	240,000	268,800	336,000	336,000	336,000	336,000

(k) The Couple was not required to pay any property tax as they had elected personal assessment for the years of assessment 1994/95 to 1999/2000 and the Couple claimed for deduction of interest expenses which exceeded the net assessable value of the Property.

(l) Upon review, the Revenue did not accept that the Taxpayer was provided with a place of residence by his employers, but considered that the amounts claimed as rentals paid by Company E for renting the Property or as rent refunds made to the Taxpayer by Company F were in fact part of the Taxpayer's employment income. Accordingly, the Revenue raised on the Taxpayer the following additional salaries tax assessments for the years of assessment 1994/95 to 1999/2000:

	1994/95	**1995/96**	**1996/97**	**1997/98**	**1998/99**	**1999/2000**
	$	$	$	$	$	$
Income	529,669	524,892	488,491	595,560	546,500	615,300
Rent/rent refund	________	________	________	________	636,000	________
Revised assessable income	1,065,669	1,050,892	1,104,491	1,231,560	1,182,500	1,251,300
Less: Total deductions	________	________	________	________	________	________
					1,180,340	1,249,140
Less: Allowances					288,000	288,000
Revised net chargeable income	1,061,494	1,045,312	1,087,301	1,209,260	892,340	961,140
Less: Net	________	________	________	________	________	________
Additional net						

chargeable	=	=	=	=	=	=
Additional tax payable thereon	==	==	==	==	==	==

(m) Accountants' Firm G, the Taxpayer's representative, objected to the aforesaid additional salaries tax assessments.

(n) In the 2000/01 Individuals Tax Return, the Taxpayer declared his total employment income as $658,620 and that Company F refunded to him a total sum of $636,000 as rent paid by him to the landlord for the period from 1 April 2000 to 31 March 2001.

(o) On 29 November 2001, the Revenue raised on the Taxpayer the following 2000/01 salaries tax assessment:

		$	$
Assessable income [$658,620+$636,000]			1,294,620
Less:	Charitable donations	200	
	Contributions to recognized retirement scheme	4,000	
	Other deductions	2,060	6,260
			1,288,360
Less:	Basic allowance	108,000	
	Child allowance	60,000	
	Dependent parent allowance	120,000	288,000
Net chargeable income			1,000,360
Tax payable thereon			159,561

(p) Accountants' Firm G objected to the 2000/01 salaries tax assessment.

(q) In its communication with the Revenue, Company F provided, inter alia, the following information:

(i) Rental reimbursement was allowed to some senior management subject to the director's approval. This housing benefit was determined on individual basis as a result of discussion between the staff and the director. Housing benefit had been provided to the Taxpayer since 1 August 1994.

(ii) Rental receipts were obtained from the Taxpayer each month to ensure that rent was actually paid by him.

(iii) The monthly salaries and rental reimbursement were directly credited into the Taxpayer's bank account each month as one payment. Company F also enclosed a copy of the Taxpayer's salary advice for

the month of August 2001 and breakdowns showing details of the remuneration reported in the employer's returns in respect of the Taxpayer for the years 1994/95 to 2000/01.

(r) In its communication with the Revenue, Company B asserted, inter alia, the following:

(i) During the period from 1 January 1994 to 31 July 1994 monthly rental of $42,000 was received from Company E.

(ii) From 1 August 1994 onwards, monthly rental was received from the Taxpayer. The amounts of monthly rental for the period from August 1994 to February 1996 and from March 1996 to December 2001 were $43,000 and $53,000 respectively.

(iii) No tenancy agreement was executed at all relevant times.

(iv) The rent due from the Taxpayer was settled by 'customary accrual and set off' against amount due to and from the directors. The liability to pay arise, hence the expenses incurred, from the Taxpayer as soon as the Property had been occupied by him for that month. Such an amount when incurred, not discharged by cash, was booked; and then set off immediately against the director's account. As each rental payment was used to set off against the director's account, the exact amount of each payment was not evidenced by a particular bank entry.

(s) In response to the Revenue's enquiries, Accountants' Firm G on behalf of the Taxpayer asserted, inter alia, the following:

(i) The Taxpayer clarified his employment agreement with Company F dated 28 April 1994 in that as soon as he reported his duty on 1 August 1994, his first salary payment had already been divided into two constituents. He enclosed and referred to a copy of Company F's internal memo dated 12 August 1994.

(ii) Company F has maintained a control system to ensure that housing allowance to its staff was properly approved and reimbursed.

(iii) The Couple leased the Property to Company B which in turn sub-let it to the Taxpayer.

(iv) There were no written tenancy agreements between the Taxpayer and Company B nor between Company B and the Couple.

(v) The terms of the tenancy agreements between the parties had never intended to be for a long term basis but subject to review on an annual basis.

(vi) The rental payment from Company B to the Couple was settled by 'customary accrual and set off' against amount due to and from the directors. The rental payment from the Taxpayer to Company B during the period from April 1994 to July 1994 was effected by bank transfers from Company E directly to the current account of Company B. A sample general journal in the books of Company B for the year ended 1999 showing how the rental income was credited was enclosed for reference. In the case of Company B and the Taxpayer, the respective income had been accrued and recorded as taxable income in its books and returns throughout the years of assessment.

(vii) Company B conducted its business of letting and sub-letting. As a matter of fact, the Property was acquired with a lease on 13 August 1991. It was continued to be leased to the then Ministry of Defence as a quarter for a military officer until 31 August 1992, when the lease was taken up by Company B. During the years of assessment, Company B was responsible for the repair and maintenance of the Property. All utility charges were and are still registered and borne by Company B. Costs of furniture and fittings of the Property were borne and paid by and properly booked in the books of Company B. In other words, the Couple let the Property to Company B on a (bare) shell basis and Company B sub-let the Property on a furnished basis.

(viii) The Couple had never issued rental receipts to the tenant, even when the Property was leased to the Ministry of Defence.

(ix) The Property was a gross area of 2,517 square feet and commanded a rental in the average of $20-21 per square foot on a furnished basis and the rental as charged was of a fair market value. Copies of three information leaflets issued by estate agents in April 2000, August 2000 and September 2000 were enclosed for reference.

(t) The Revenue has ascertained that the rateable values of the Property at the material time are as follows:

Year of assessment	Rateable value
	$
1994/95 – 1996/97	450,000
1997/98 – 1998/99	607,800
1999/2000	520,200
2000/01	504,600

(u) It has come to the Revenue's attention that the correct amount of the alleged rent refunds made by Company F to the Taxpayer for the year ended 31 March 1997 should be $636,000 ($53,000 × 12) instead of $616,000 previously reported by the Taxpayer in his 1996/97 tax return. The Revenue now considers that the additional salaries tax assessment for the year of assessment 1996/97 should be increased as follows:

	$
Revised assessable income [$488,491 + $636,000]	1,124,491
Less: Total deductions	17,190
Revised net chargeable income	1,107,301
Less: Net chargeable income assessed	317,971
Revised additional net chargeable income	789,330
Additional tax payable thereon	110,301

Issues & onus of proof

4. As culled from all the materials submitted to the Board, in particular the grounds of appeal filed by Accountants' Firm G on behalf of the Taxpayer on 22 March 2004, the issues are as follows:

(a) whether the Revenue was estopped from re-opening the assessments in respect of the issue of housing assistance due to the enquires raised by the Revenue in 1996;

(b) whether the amounts of the housing assistance provided by Company E for the period from 1 April 1994 to 23 July 1994 and Company F from 1 August 1994 to 31 March 2001 were rental refund or simply cash allowance which did not amount to a rental refund;

(c) whether the Taxpayer and Company B intended to create legally binding sub-tenancy agreement between them in respect of the Property; and

(d) whether the sub-letting of the Property by Company B to the Taxpayer amounted to a transaction which was fictitious or artificial within the meaning of

section 61 of the Inland Revenue Ordinance (Chapter 112) ('IRO') and therefore should be disregarded.

5. The Taxpayer has the onus of proving that the additional salaries tax assessments and the salaries tax assessment in dispute are incorrect or excessive. [See section 64(4) of IRO].

Evidence

6. Having explained to the Taxpayer the relevant procedure on his appeal to the Board the Taxpayer elected to give sworn evidence before the Board. We do not think it is necessary to recapitulate all his evidence save to the extent that it is material to resolve the issues at hand and whether his evidence is credible.

7. The Taxpayer said that when Company E employed him as manager of the corporate services department, he was responsible for providing company secretarial services to its clients and providing training to its trainee solicitors. After he left his employment with Company E, he began his employment with Company F as manager of the company secretarial and legal department responsible for Company F's compliance with the listing rules. The basic nature of his employment with Company F has remained the same since then. Although he is not qualified as a lawyer, he has a master of laws degree and is a fellow member of the Hong Kong Institute of Company Secretary.

8. According to the Taxpayer, the Couple orally let the Property to Company B in September 1992 after Her Britannic Majesty's Secretary of State for Defence moved out of the Property. The Taxpayer admitted that there was not much detail about the tenancy agreement between the Couple and Company B and that Company B was not required to pay any rental deposit. He said that Company B agreed to pay rent in the early part of each month and that Company B was responsible to furnish the Property and to pay the management fee, utility charges, rates, maintenance and repairs expenses. As between Company B and the Taxpayer, the Taxpayer said that Company B orally sub-let the Property to the Taxpayer also in September 1992. Under the sub-lease, Company B agreed to pay rent in the early part of each month and that the rent was all-inclusive. Subsequently, the Taxpayer accepted that insofar as his employment with Company E was concerned, Company E credited the bank account of Company B with the rental in the middle of each month. [See R1:133-136]. According to the Taxpayer, he was not required to pay any rental deposit under the sub-lease. When being cross examined by the Revenue's representative, the Taxpayer said that there was a common understanding between the Couple, Company B and himself that the rentals under the head-lease and the sub-lease were fixed according to the market rental. The Taxpayer agreed that the rentals under the head-lease and the sub-lease had remained at $35,000 and $53,000 respectively since March 1996 notwithstanding that the rateable value of the Property has changed throughout the relevant years of assessment. Although the Taxpayer agreed that the market value of the Property had gone up and down, he nevertheless did not agree that the market rental of the Property had changed a lot. He attempted

to bolster this part of his evidence by referring to Appendix I to A1 (the Taxpayer's letter to the Clerk to the Board dated 20 May 2004). But when taxed by the Revenue's representative, the Taxpayer agreed that Appendix I to A1 only contained copies of information leaflets issued by different estate agents in the year of 2000. The Taxpayer also attempted to strengthen this part of his evidence by referring to his 10 years' working experience with Company F notwithstanding that he was mainly responsible for compliance matters regarding Company F.

9. The Revenue's representative cross examined the Taxpayer on Company B's audited accounts from 1994/95 to 1997/98. When the Taxpayer was cross examined on the substantial addition of furniture and fixtures in the financial year of 1997 [See R1:254], he said that Company B added the furniture and fixtures on its own volition, not at the request of the Taxpayer. The Taxpayer also accepted the suggestion of the Revenue's representative that despite the substantial addition of furniture and fixtures in the financial year of 1997, Company B had not adjusted the rental under the sub-lease to reflect this.

10. On the proportion of the amount of housing assistance borne to the overall monthly earnings of the Taxpayer, it is beyond dispute that the amount of housing assistance has formed a substantial part of his monthly earnings. In relation to his employment with Company E, the Taxpayer said during cross examination that we had to look at his entire package and the package stated in paragraph 1(2) of the determination was the entire package he could successfully reach with Company E and that it was Company E's policy to give housing allowance benefit to his staff and to credit the sum directly with the landlord's account. The Taxpayer left his employment with Company E on 23 July 1994. The Taxpayer however agreed that Company E had not chased him for the return of the rental already paid to Company B in respect of the period from 24 July 1994 to 31 July 1994. The Taxpayer did not believe that Company E would be so mean that they would chase him for the return of the rental for such period. Inasmuch as his employment with Company F is concerned, the Taxpayer said that Company F had no rent refund policy and that it all depended on each individual employee's negotiation with the company. He did not know whether Company F had capped the amount of rent refund. He agreed as a result of the Board's enquiry that at the time of negotiation with Company F, he was paying rent to the tune of $48,000 to Company B and that only after the amount of $43,000 was agreed by him and Company F as rent refund did Company B agree to reduce the monthly rental from $48,000 to $43,000.

11. During cross examination, the Revenue's representative submitted a breakdown of the Taxpayer's monthly income and bonus from August 1994 to March 1997. The breakdown was prepared from the materials furnished by the relevant parties [See B1:20-23 & R3:272-273]. The Taxpayer disagreed with some of the descriptions in the breakdown. He was specifically asked about the no pay leave deduction which the Revenue's representative suggested as inclusive of housing assistance. The Taxpayer however could not remember the basic daily pay rate on which Company F had adopted to calculate the no pay leave deduction.

12. As regards the director's current account of Company B, the Taxpayer said that it was only prepared by Company B's accountant by the end of each financial year. The director's current account of Company B, according to the Taxpayer, was not compiled monthly. The amounts of housing assistance paid by Company F each year would only be booked in the director's current account by the end of each financial year.

13. Finally, the Revenue's representative questioned the Taxpayer about the enquiry raised by the Revenue in 1996. The Taxpayer agreed that as appeared in R1:111, the only enquiry raised by the Revenue in 1996 was about the Couple's Property Tax Return for the years of assessment 1991/92 to 1994/95. He also agreed that the Revenue had not enquired about the head-lease between the Couple and Company B and the sub-lease between Company B and himself.

14. After cross examination, the Taxpayer further elaborated that for each month, the company only refunded rental on the basis of rental receipt submitted by him. He said that sometimes, the company was late in giving him the rental refund. He reiterated that the landlord-and-tenant relationship, be it between the Couple and Company B or between Company B and the Taxpayer, was genuine landlord-and-tenant relationship and was consistently reflected in the tax returns submitted.

Estoppel

Law

15. As a matter of general principle, the Revenue is usually not estopped from carrying out its statutory obligation. It cannot be prevented either by agreement or otherwise from discharging its duties under statute.
[See Extramoney Limited v Commissioner of Inland Revenue HKTC vol 4 394 at page 423]

16. It does not follow that the Revenue is under no circumstance subject to an estoppel.
[See Extramoney Limited v Commissioner of Inland Revenue (supra.) at page 423]

17. In Case No D52/87, IRBRD, vol 2, 461 at pages 471-473, the Board of Review enunciated the circumstances under which the doctrine of estoppel could operate.

> '*Even if the appellant had simply left it all to his accountants it would not follow that the previous classification should totally be ignored. The attempted re-classification is clearly inconsistent with the agreed basis upon which profits and losses had been computed and aggregated, the assessments raised and paid and the investigation brought to a close.*

It may be convenient at this junction to consider to what extent, if any, the appellant is precluded from attempting to re-classify the shares. Outside the field of Revenue law the rule is well established that in general when parties have agreed to act upon an assumed state of facts their right in the transaction are made to depend on the facts assumed to be true. This species of estoppel is sometimes called "estoppel by convention" perhaps to emphasize the point that the estoppel can arise even if the agreement falls short of contract: see Spencer Bower and Turner "Estoppel by Representation" 3rd Edition pp. 157 et seq and the case of Amalgamated Property Co v Texas Bank (CA) (1982) 1 QB 84 of Kean v Holland [1984] 1 WLR 251. In the field of Revenue law however the principle is ordinarily of no application (if it ever applies at all) since the Revenue does not usually stand in the same position to the taxpayer as one party to a commercial transaction stands to another; the finality or otherwise of assessments is governed by statute which lays down a complete code setting out the circumstances in which assessments can be reopened, corrected and additional assessmenst made. There are, however, cases like the present (1) where the Revenue and the taxpayer negotiate for and eventually reach a settlement of the taxpayer's affairs (2) where a particular treatment of relevant items depends essentially not on law but on fact (3) where the taxpayer by himself or through his tax representatives adopted or accepted a particular treatment of the items as part of the agreed state of facts on which the settlement is to be reached (4) where the treatment is known to have a decisive bearing not only on the amount of the assessments for the period under investigation but also on the status of the items in question beyond the period directly covered by the settlement (5) where assessments are then raised and paid on the basis of the facts and figures agreed and (6) where the assessments themselves have become final and conclusive under Section 70. A question which has exercised our minds is whether in such cases (where all six conditions obtain), the taxpayer would be estopped from treating the items in question in a manner which was inconsistent with the previous agreed treatment even in a case where the new exercise was directed to a period subsequent to that directly covered by the assessments which had become final and conclusive. Quite clearly, if the new exercise were based on a change of intention which had the effect in law of shifting the items into a new category that would be something which would not be inconsistent with the previous agreed state of facts. In the present case, however, what we are faced with is a re-classification of shares put forward on the basis that these shares should never have been placed on the previously agreed category.

...

We have not found the estoppel point an easy one and while not rejecting the possibility of its application in cases where all six conditions obtain and the taxpayer is unable to point to any vitiating factor in the prior agreement which produced the settlement we do have reservations about the general relevance of the doctrine of estoppel to assessments under the Inland Revenue Ordinance.'

Analysis

18. The Taxpayer contended that the Revenue had been well aware of the landlord-and-tenant relationship between the parties since July 1996 when the Revenue made the first enquiry. The Taxpayer also contended that the questioning in 1996 was a detailed one and that the Revenue had a change of heart only around two years ago. In our view, the Taxpayer's contention is not borne out by his evidence before the Board and the contemporaneous documents (R1:111-116). He agreed in evidence that as appeared in R1:111, the only enquiry raised by the Revenue in 1996 was about the Couple's Property Tax Return for the years of assessment 1991/92 to 1994/95 and that the Revenue had not enquired about the head-lease between the Couple and Company B and the sub-lease between Company B and himself. The Taxpayer's evidence falls short of establishing an unequivocal acceptance on the part of the Revenue that the amounts of housing assistance given by Company E and Company F were rent refund and that the relationships between the relevant parties were genuine landlord-and-tenant relationships, let alone a settlement of the Taxpayer's affairs in question after negotiation. To hold otherwise would unduly restrict the Revenue from carrying out its statutory obligation. Under section 60 of IRO, an additional assessment may be raised by an assessor if a taxpayer chargeable to tax has not been assessed to tax or has been assessed at less than the proper amount and that the assessment must be made within the relevant year of assessment or within six years after the end of that year [See also Proviso to section 70 IRO].

19. Accordingly, we reject the Taxpayer's estoppel contention.

Rental Refund v Cash Allowance

Law

20. 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 income. 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 provided for in section 9(1A) of IRO
[See Case No D8/82, IRBRD, vol 2, 8, at page 10;
Case No D56/00, IRBRD, vol 15, 563, at pages 578-579]

21. The ordinary meaning of 'refund' connotes a repayment of reimbursement, not mere payment.
[See Case No D19/95, IRBRD, vol 10, 157, at page 160;
Case No D33/97, IRBRD, vol 12, 228, at page 239]

22. After citing Case No D21/98, IRBRD, vol 13, 203, Recorder Edward Chan SC held the following in Commissioner of Inland Revenue v Peter Leslie Page HKTC Vol 5, 683, at pages 693-694:

> '*As I have indicated above, I agree with the notion that refund should mean "pay back" or "reimbursement". Hence unless the taxpayer had made a payment as rent, there could be no question of his receiving any refund of rent from his employer. Likewise, if the employer merely made a payment to the employee without regard or reference as to whether the employee had made any payment for rent or not, it would be difficult to see how it could be said that the payment made by the employer could amount to a refund of rent paid by the employee. However in my view, it is wrong to suggest that in order to make the payment by the employer as a refund of rent, the employer would have to exercise some control over the ways in which the amount paid to the taxpayer is to be spent. Insofar as there is anything in the 2 passages cited above suggesting to the contrary, I am of the view that such suggestion is wrong. This is because where a taxpayer has spent money to pay rent and his employer then reimburses him of the amount he paid, the money he receives from his employer would then become his own money, and he must be free to spend his money in whatever way he wants. It would be wrong to impose an obligation on the part of the taxpayer to spend the money he received from his employer in any particular way such as only for the purposes of his own housing. A "refund" of rent would connote that the person receiving the "refund" has already spent his own money to pay rent. Thus when he receives the "refund", the money he so obtains back would become his money and is not to be further burdened by any obligation as to how it could be spent.*'

23. As held by Recorder Edward Chan SC in the case of Peter Leslie Page (Supra.) at pages 690, 694-697, to ascertain the nature of the housing assistance, the starting point should be the contract of employment. If by the terms of the contract of employment, the payment is to be in the nature of rental refund, then plainly due weight must be given to the contractual provision. Although the terms of the contract of employment are an important and weighty factor, this is not the sole factor because, among other things, the parties' conducts may be such that the payment is not made in strict accordance with the terms of the contract and so the payment may be of a nature different from what is provided for in the contract. The relevant point of time, as held by Recorder

Edward Chan SC, is the time of the payment of the money by the employer and not the point of time when the parties entered into the contract of employment.

Analysis

24. Due to the lapse of time, the Taxpayer was unable to produce his employment contract with Company E. It is however plain and obvious that Company E credited the rental payment with Company B's account directly [See R1:133-136].

25. Insofar as his employment with Company F is concerned, the Taxpayer produced his employment contract dated 28 April 1994 [See B1:24-25] and various memoranda issued by Company F to him [See B1:26, R1:137-139]. On a reading of the memoranda, Company F intended that the amounts of housing assistance paid to the Taxpayer was in the nature of rental refund. Company F also asserted in its correspondence with the Revenue that it had obtained rental receipts from the Taxpayer each month to ensure that he had actually paid the rent. However, when we look at the breakdown of the Taxpayer's monthly income and bonus from August 1994 to March 1997 submitted by the Revenue's representative during cross examination of the Taxpayer and Appendix A to his written final submissions, Company F made provident fund contributions (5% of the Taxpayer's income) for the Taxpayer from August 1995 to March 2001. The amounts of provident fund contributions made by Company F from August 1995 to February 2001 were calculated on the basis of 5% of the Taxpayer's income inclusive of the amounts of housing assistance paid to the Taxpayer. How the Taxpayer treated the amounts of housing assistance received is also pertinent to the question whether the payments were rental refund or housing allowance. It is beyond dispute that the Taxpayer has never made actual payment rental to Company B. According to the Taxpayer, the rent due from him to Company B was settled by 'customary accrual and set off' against amount due to and from the directors. The Taxpayer admitted in evidence that the director's current account of Company B was only prepared by Company B's accountant by the end of each financial year and the amounts of housing assistance paid by Company F each year would only be booked in the director's current account by the end of each financial year [See A2:68-69, 67, 65-66, 64, 61-63, 58-60, 55-57]. In other words, the Taxpayer had not incurred any rental expenses prior to his receipt of the amounts of housing assistance from Company F. Insofar as the Taxpayer's employment with Company F is concerned, we reject the Taxpayer's contention and evidence that actual rents had been incurred and paid among the parties and subsequently refunded by Company F.

26. Accordingly, we hold that at the time of Company F making payments of housing assistance to the Taxpayer, the nature of the payments was not rental refund, but rental allowance. We would hold the same irrespective of the genuineness of the sub-lease between Company B and the Taxpayer. As regards the amounts of the housing assistance paid by Company E, whether they are exempt or not depends on our resolution of the following two issues.

Intention to create legally binding sub-tenancy agreement

Law

27. If there was no relationship of sub-tenancy, the payments of housing assistance made by Company E and Company F during the relevant years of assessment would be treated as cash allowance and taxable as employment income. It is not enough simply to rely on 'the formal niceties of paying cheques to a family member, issuing receipts and completing property tax returns'. [See Case No D33/97 (supra.) at page 239]

Analysis

28. Having considered all the evidence, that is, the oral testimony of the Taxpayer and various documents produced before us, we do not accept that the Taxpayer and Company B intended to create a legally binding sub-tenancy agreement between them in respect of the Property. Our reasons are as follows:

(a) The Property was at all material times owned by the Couple as joint tenants. The Taxpayer has every legal right to use the Property as his residence. We accept that there is absolutely no need for the Couple to let the Property to Company B and for Company B to sub-let the Property back to the Taxpayer in the roundabout way before the Taxpayer could use the Property as residence for himself and his family. The Taxpayer explained in his written submissions and evidence that as tenant of Company B, he would have more security in occupying the Property since in the event of a divorce, the Couple would have to honour the existing tenancy agreement with Company B. We do not accept that that is a relevant consideration since the Taxpayer agreed in evidence that at the time when the tenancy and sub-tenancy agreements were entered into by the parties, the question of divorce or security of occupation did not figure in his mind. The Taxpayer only put in this explanation ex post facto to rebut the reasoning of the Deputy Commissioner of Inland Revenue in the Determination.

(b) There was no written tenancy agreement between the Couple and Company B. Neither was there any written sub-tenancy agreement between Company B and the Taxpayer. We should not be taken to suggest that in order to be binding, any tenancy agreement or sub-tenancy agreement should be in writing. However, the absence of a written tenancy agreement or sub-tenancy agreement between the relevant parties containing black and white terms governing their relationship is a factor negating the intention of the relevant parties to create a legally binding relationship. This is particularly so in the present case. The Property occupied a prime location and generated a high rental return.

(c) The Taxpayer admitted in evidence that there was not much detail about the tenancy agreement between the Couple and Company B and that Company B was not required to pay any rental deposit. He said that Company B agreed to pay rent in the early part of each month and that Company B was responsible to furnish the Property and to pay the management fee, utility charges, rates, maintenance and repairs expenses. As between Company B and the Taxpayer, the Taxpayer said that Company B orally sub-let the Property to the Taxpayer also in September 1992. Under the sub-lease, the Taxpayer agreed to pay rent in the early part of each month and that the rent was all-inclusive. According to the Taxpayer, he was not required to pay any rental deposit under the sub-lease. Although we accept that subject to some legal constraints, contracting parties are free to enter into whatever bargain they like, it is nevertheless unusual to see a tenancy agreement without a provision of rental deposit. In our view, it is a factor against the Taxpayer.

(d) It is undisputed that the Taxpayer has never made any actual payment of rental to Company B. Notwithstanding the Taxpayer's case that he had agreed to pay rental to Company B <u>in the early part of each month</u>, it is nevertheless plain and accepted by the Taxpayer in evidence that insofar as his employment with Company E was concerned, Company E credited the bank account of Company B with the rental <u>in the middle of each month</u> [See R1:133-136]. Company B accepted payments without demur. Insofar as his employment with Company F is concerned, the rent due from him to Company B was, according to the Taxpayer, settled by 'customary accrual and set off' against amount due to and from the directors. The Taxpayer admitted in evidence that the director's current account of Company B was only prepared by Company B's accountant by the end of each financial year and the amounts of housing assistance paid by Company F each year would only be booked in the director's current account <u>by the end of each financial year</u> [See A2:68-69, 67, 65-66, 64, 61-63, 58-60, 55-57].

(e) The substantial addition of furniture and fixtures in the financial year of 1997 [See R1:254] on Company B's own volition without adjustment in rental. Seldom do we come across a situation where during the currency of a tenancy agreement, landlord volunteers to refurbish the leased property without even a request from the tenant.

(f) When being cross examined by the Revenue's representative, the Taxpayer said that there was a common understanding between the Couple, Company B and himself that the rentals under the head-lease and the sub-lease were fixed according to the market rental. We reject this piece of evidence. Not only did

the Taxpayer agree that the rentals under the head-lease and the sub-lease had remained at $35,000 and $53,000 respectively since March 1996, but also that the rateable value of the Property had fluctuated throughout the relevant years of assessment. The Taxpayer opined that although the market value of the Property had gone up and down, the market rental of the Property had not changed a lot. We reject his opinion as being contrary to rateable values of the Property throughout the relevant years of assessment. Copies of information leaflets issued by different estate agents in the year of 2000 are not representative of the market rental of the Property for the relevant period at all.

29. The foregoing are the reasons why we hold that the Taxpayer and Company B did not intend to create a legally binding sub-tenancy agreement between them in respect of the Property. Before we reach this conclusion, we have borne in mind all the arguments and evidence advanced by the Taxpayer. In our view, the issue of rental receipts [See B1:29-35] and treatment of the housing assistance received by the Taxpayer and his connected parties in their tax returns are self-serving. In particular, the rental receipts issued by the Taxpayer do not even stipulate the date of issue.

30. If we had been required by this case to hold whether or not the Couple and Company B intended to enter into a legally binding tenancy agreement between them in respect of the Property, we would have held that they did not. Apart from the reasons given by us in paragraphs 28 and 29 hereinabove, it is clear from the director's current account of Company B prepared by Company B's accountant by the end of each financial year that Company B only paid rental to the Taxpayer (presumably the Taxpayer has all along been representing the Couple to receive the rental from Company B) in one lump sum per annum and so booked therein by the end of each financial year [See A2:68-69, 67, 65-66, 64, 61-63, 58-60, 55-57].

31. For the aforesaid reasons, the appeal must fail. Accordingly, we hereby confirm the Determination and dismiss the appeal by the Taxpayer.

Fictitious or artificial relationship within the meaning of section 61 of IRO

32. The Board of Review Decision in Case No D77/99, IRBRD, vol 14, 528 provides us with a useful guidance as how we should deal with issues arisen under section 61 of IRO.

33. Having dismissed the appeal as aforesaid, there is no need for us to consider whether the sub-letting of the Property by Company B to the Taxpayer amounted to a transaction which was fictitious or artificial within the meaning of section 61 of IRO. Had it been necessary for us to do so, we would have concluded that, in light of all the evidence before us, the reasons given in paragraphs 28, 29 and 30 hereinabove and the legal principles enunciated in Case No D77/99 (supra.), the letting arrangement between the Couple and Company B and the sub-letting arrangement between Company B and Taxpayer were artificial and fictitious.