

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D33/04

Salaries tax – home loan interest – refinance of mortgage – obtained or obtained wholly for the acquisition of a dwelling – section 26E of the Inland Revenue Ordinance ('IRO').

Panel: Patrick Fung Pak Tung SC (chairman), Dianthus Tong Lau Mui Sum and Lily Yew.

Date of hearing: 1 June 2004.

Date of decision: 20 August 2004.

The taxpayer's spouse ('the Spouse') purchased a tenanted property ('the Property') financed mainly by way of mortgage loan ('Loan 1') in July 1991.

In 1994, the taxpayer used the Property as residential dwelling.

The Spouse then obtained Loan 2, Loan 3 and Loan 4 from various financial institutions to fully repay the then outstanding principal of Loan 1, Loan 2 and Loan 3 respectively in May 1996, June 1997 and December 1999.

In the 1998/99 Budget, concessionary deduction to individuals for interest paid on home acquisition mortgage loan was announced.

The Spouse nominated the taxpayer to claim the home loan interest deduction.

At first, the actual amount of Loan 1 at the time of acquisition of the Property in 1994 could not be ascertained.

The outstanding balance of Loan 2 was known to be \$2,385,336 when it was fully repaid by Loan 3 (\$3,500,000) obtained by the Spouse in June 1997.

The computed ratio of [outstanding balance of Loan 2 (\$2,385,336)/ Loan 3 (\$3,500,000) in June 1997] had been used to calculate the allowable home loan interest and the taxpayer was allowed \$100,000, the maximum allowable, for the years of assessment 1998/99, 1999/2000, 2000/01.

On 7 October 2002, for the year of assessment 2001/02, when the maximum home loan interest allowable was increased to \$150,000, the assessor overlooked and failed to apply any computed ratio and fully allowed the \$138,297 interest paid on Loan 4.

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On 18 August 2003, 2001/02 additional assessment was then raised to apply the computed ratio and the home loan interest deduction adjusted and reduced to \$94,254. An additional tax of \$7,487 was thus payable. The taxpayer objected to the same.

After the outstanding balance of Loan 1 in May 1996 was ascertained, revised computed ratio was derived which was then used to calculate the allowable home loan interest.

The assessor proposed to revise the 2001/02 additional assessment to further reduce the home loan interest deduction to \$56,840 and so revised additional tax payable increased to \$13,848.

The taxpayer raised an objection but the Commissioner determined against the taxpayer and invited him to withdraw his objection.

The taxpayer appealed.

Held:

1. The Board considered all the evidence and came to the view that Loan 2, Loan 3 and Loan 4 were not obtained or obtained wholly for the acquisition of a dwelling within the meaning of section 26E of the IRO.
2. The revised 2001/02 additional assessment made and the concessions granted by the Inland Revenue Department were reasonable.

Appeal dismissed.

Cases referred to:

D22/01, IRBRD, vol 16, 220

D123/01, IRBRD, vol 16, 915

D18/02, IRBRD, vol 17, 483

Wong Kai Cheong for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

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1. This is an appeal by the Appellant ('the Taxpayer') against the determination of the respondent ('the Commissioner') dated 23 February 2004 whereby she acting by her deputy rejected the objection of the Taxpayer to the assessment and demand for additional salaries tax for the year of assessment 2001/02 raised on him in the sum of \$13,848.

The facts

2. There is practically no dispute on the relevant facts which can be extracted from the determination as follows:

- (i) On 3 July 1991, the Taxpayer's spouse ('the Spouse') purchased the Property at a price of \$2,931,000. On the same day, the Spouse used the Property to secure a loan of \$2,344,800 from Finance Company A ('Loan 1').
- (ii) On 14 May 1996, the Spouse, with the Property as security, obtained a loan of \$2,500,000 from Bank B ('Loan 2') and repaid the outstanding principal of Loan 1 in full.
- (iii)
 - (a) On 27 June 1997 the Spouse, with the Property as security, obtained a loan of \$3,500,000 from Finance Company C ('Loan 3').
 - (b) On the same day, she fully repaid the outstanding principal of \$2,385,336 of Loan 2.
- (iv)
 - (a) On 24 December 1999 the Spouse, with the Property as security, obtained a loan of \$3,215,000 from Bank D ('Loan 4').
 - (b) On the same day, the outstanding principal of Loan 3 in the amount of \$3,227,048.42 was fully repaid.
- (v) In his 1998/99 tax return, the Taxpayer declared an employment income of \$1,125,960.
- (vi) On 22 September 1999, the assessor raised on the Taxpayer the following salaries tax assessment for the year of assessment 1998/99:

Income	\$1,125,960
Less: Married person's allowance	216,000
Child allowance	<u>60,000</u>
Net chargeable income	<u><u>\$849,960</u></u>

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Tax payable \$133,993

(vii) By letter dated 20 October 1999, the Taxpayer alleged that he should be allowed deduction of home loan interest for the year of assessment 1998/99. He stated that :

- ‘ 1. (The Property) was bought in 1992 from the developer with tenant (Government quarters) contract. The reason we bought the property is mainly for self use but not for investment ...
2. ... in year 1992, no bankers were willing to offer mortgage loan to house in the New Territories, especially for property with tenant contract. The only lender at that time was the developer with lots of harsh terms such as large down payment, short repayment schedules (12 years without alternatives), high interest rate, harsh penalty ...
3. In 1994, I successfully got my property back for self residential use. Since more and more banks were offering better interest rates, flexible repayment schedules, cheaper insurance, in order to suit my best personal financial planning, I started to decide to change my mortgage loan to another bank and raised my mortgage loan to 3.5 million (Loan 3) in order to repay the loan from my relatives for the down payment of this property and do some necessary maintenance due to wear and tear inside the dwelling after all these years to a live in condition.
4. As you could clearly see that all of these changes were made before the home loan interest tax deduction announced. This is a strong evidence to proof that the present mortgage is mainly for my own personal financial planning and not the tactics for getting any benefits from the home loan interest tax deduction. All the money from the mortgage were used back in the dwelling.... So in order to be fair to me the home loan interest tax deduction should be assessed according to my existing mortgage loan.
5. I am unable to provide you the documents concerning the amount of outstanding principle (sic) at the date of redemption of the first mortgage cause I did not keep these outdated record which has nothing to do with my present mortgage loan and all these past records had already come to an end under my personal file.’

The Taxpayer supplied copies of the repayment schedules of Loan 3 issued on 21 January 1998, 8 April 1998, 27 October 1998, 23 December 1998, 23 January

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1999 and 20 April 1999 showing total interest of \$327,692 incurred during the year ended 31 March 1999.

- (viii) On 29 December 1999, the Assessor revised the Taxpayer's 1998/99 salaries tax assessment to allow home loan interest as follows:

Net chargeable income	\$849,960
Less: Home loan interest	100,000
Revised net chargeable income	<u>\$749,960</u>
Revised tax payable	<u>\$116,993</u>

- (ix) (a) In his tax returns for the years of assessment 1999/2000, 2000/01 and 2001/02, the Taxpayer declared the following particulars in respect of his claim for deductions of home loan interest:

	1999/2000	2000/01	2001/02
Location of property	The Property	The Property	The Property
The Taxpayer's share of ownership	0%	0%	0%
The Spouse's share of ownership	100%	100%	100%
The property was occupied as the Taxpayer's residence for the full year	Yes	Yes	Yes
Amount of loan	(i) \$3,500,000 (Loan 3)	NA	NA
	1999/2000 (ii) \$3,215,000 (Loan 4)	2000/01	2001/02
Date of granting of loan	(i) 27-6-1997 (ii) 24-12-1999	NA	NA
Is the loan secured by a mortgage or charge?	Yes	Yes	Yes
A re-mortgaged loan is involved	[blank]	[blank]	[blank]

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Total amount of interest paid on the loan by the owner during the year	(i) \$206,535 (ii) <u>\$68,743</u> <u>\$275,278</u>	NA	NA
Home loan interest Deduction claimed by way of spouse's nomination	(i) \$206,535 (ii) <u>\$68,743</u> <u>275,278</u>	<u>\$256,256</u>	<u>\$138,297</u>

(b) For the year of assessment 2001/02 the Taxpayer declared an employment income \$1,140,858 and claimed deduction of outgoings and expenses \$1,470 and child allowance in respect of his two children.

(x) (a) On divers dates, the assessor raised on the Taxpayer 1999/2000 and 2000/01 salaries tax assessments with the deduction of home loan interest of \$100,000 for each year. The Taxpayer did not object to the assessment.

(b) On 7 October 2002, the assessor raised on the Taxpayer the following salaries tax assessment for the year of assessment 2001/02:

Income	\$1,140,858
<u>Less: Home loan interest</u>	138,297
Outgoings and expenses	<u>1,470</u>
	1,001,091
<u>Less: Married person's allowance</u>	216,000
Child allowance	<u>60,000</u>
Net chargeable income	<u>\$725,091</u>
Tax payable	<u>\$112,765</u>

(c) To give effect to the Tax Exemption (2001 Tax Year) Order, salaries tax payable by the Taxpayer for the year of assessment 2001/02 was reduced from \$112,765 to \$109,765.

(xi) (a) Upon review, the assessor noticed that the Taxpayer's claim for home loan interest \$138,297 as stated in his tax return for the year of assessment 2001/02 was on a re-mortgaged loan (Loan 4) under which a ban of \$3,215,000 was obtained and the outstanding principal of Loan 3 in the sum of \$3,227,048.42 had been repaid.

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- (b) On 18 August 2003, the assessor raised on the Taxpayer the following 2001/02 additional salaries tax assessment so as to adjust the home loan interest deduction to \$94,254:

Income	\$1,140,858
<u>Less: Home loan interest</u>	94,254
Outgoings and expenses	<u>1,470</u>
	1,045,134
<u>Less: Married person's allowance</u>	216,000
Child allowance	<u>60,000</u>
Net chargeable income*	\$769,134
<u>Less: Amount previously assessed</u>	<u>725,091</u>
Additional net chargeable income	<u>\$44,043</u>
Tax payable on * above	\$117,252
<u>Less: Tax previously assessed</u>	<u>109,765</u>
Additional tax payable	<u>\$7,487</u>

- (xii) The Taxpayer objected to the above 2001/02 additional salaries tax assessment.

- (xiii) The assessor ascertained that the outstanding principal of Loan 1 as at 14 May 1996 was \$1,507,855.

- (xiv) The assessor considered that:

- (a) Loan 1 was for the acquisition of the Property on 3 July 1991.
- (b) In respect of Loan 2 obtained on 14 May 1996, the portion used to pay off the unpaid balance of Loan 1 was

$$\frac{\$1,507,855}{\$2,500,000} \times 100\% = 60.31\%$$

- (c) In respect of Loan 3 obtained on 27 June 1997, the portion applied for the acquisition of the Property was

$$\frac{\$2,385,336}{\$3,500,000} \times 60.31\% \times 100\% = 41.10\% \text{ ('the Portion')}$$

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- (d) On 24 December 1999, the whole of Loan 4 was obtained to repay the outstanding principal of Loan 3. The Portion was also applied to Loan 4 as for the acquisition of the Property.
- (xv) The assessor proposed to revise the 2001/02 additional salaries tax assessment as follows:

Income	\$1,140,858
<u>Less:</u> Home loan interest { \$138,297 × 41.10% }	56,840
Outgoings and expenses	<u>1,470</u>
	1,082,548
<u>Less:</u> Married person's allowance	216,000
Child allowance	<u>60,000</u>
Net chargeable income *	\$806,548
<u>Less:</u> Amount previously assessed	725,091
Additional net chargeable income	<u>\$81,457</u>
Tax payable on * above	\$123,613
<u>Less:</u> Tax previously assessed	<u>109,765</u>
Additional tax payable	<u>\$13,848</u>

- (xvi) An objection was lodged by the Taxpayer against the same.
- (xvii) As stated in paragraph 1 above, a determination against the Taxpayer's objection was made by the Commissioner which forms the subject-matter of the present appeal.

The case of the taxpayer

3. The Taxpayer has basically made two points:
- (i) The tax law was changed in 1998 as a concession by government to assist middle class citizens by allowing a deduction of 'home loan interest' from income assessable for tax purposes. He was a member of the class intended to benefit and hence should be allowed to take the benefit in full.
- (ii) The Inland Revenue Department had previously given him the full benefit of deduction of home loan interest in the sum of \$100,000. It discovered its mistake subsequently and tried to redress it. It should not be allowed to do so.

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The case of the Commissioner

4. The Commissioner plainly admits that the way that her Department had handled the matter vis-a-vis the Taxpayer was not satisfactory. She is, however, under a duty to administer the law to demand and receive whatever tax is due and payable from a taxpayer. She is within the six-year limitation period in assessing and demanding additional salaries tax against the Taxpayer in the present case.

5. By a letter dated 18 September 2003 from the Inland Revenue Department to the Taxpayer, the former apologized to the latter for the misunderstanding caused to him. It also explained to him the effect of the relevant statutory provisions and how they applied to his case. The relevant parts of that letter read as follows:

‘ In your case, the subject property, which was used as your dwelling since 1994, was **acquired** by your wife in 1991 at a cost of \$2,931,000. While the actual amount of the various loans (including loans from the developer and from relatives) at the time of acquisition cannot be ascertained now, it is noted that the outstanding balance of the loan (from [Bank B] – the earliest known banker) at June 1997 was **\$2,385,336**. Your wife redeemed that loan by **part** of the loan of \$3,500,000 obtained from [Finance Company C]. In this connection, I have to say that the excess loan of \$1.1M odd cannot be regarded as having been applied for the **acquisition** of the property.

Therefore, for the past years, we have used the above-computed ratio to calculate the allowable home loan interest for you and the amount allowed, by way of spouse’s nomination, for each year is summarized in the following table.

Year of assessment	Interest paid (\$)	Qualifying portion	Interest allowed
		<u>2,385,336</u> 3,500,000	(Restricted to Maximum Limited)
		(\$)	(\$)
1998/1999	327,692	223,330	100,000
1999/2000	275,278	187,608	100,000
2000/2001	279,461	190,460	100,000
2001/2002	138,297	94,254	94,254’

It also invited him to withdraw his objection but he refused.

The law

6. The granting of a concessionary deduction to individuals for interest paid on mortgages obtained to finance the acquisition of their homes was announced in the 1998-99

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Budget. It resulted in the enactment of, inter alia, section 26E of the Inland Revenue Ordinance Chapter 112 ('the IRO').

7. The relevant parts of section 26E of the IRO read as follows:

'26E. Home loan interest

(1) *Subject to the other provisions of this section and to section 26F, where a person pays during any year of assessment any home loan interest for the purposes of a home loan obtained in respect of a dwelling which is used at any time in that year of assessment by the person exclusively or partly as his place of residence, a deduction in respect of the home loan interest shall be allowable to that person for that year of assessment.*

(2) (a) *Subject to paragraphs (b) and (c) and subsection (3), a deduction allowable to a person under subsection (1) in respect of any home loan interest paid by the person during any year of assessment shall be –*

(i) (A) *where the dwelling is used by the person exclusively as his place of residence during the whole of that year of assessment, the amount of the home loan interest paid; or*

(B) *in any other case, such amount (whether representing the full amount of the home loan interest paid or any part thereof) as is reasonable in the circumstances of the case; or*

(ii) *the amount specified in Schedule 3D in relation to that year of assessment,*

whichever is of the lesser amount.

(b) *For the purposes of this section, where a dwelling is held by a person otherwise than as a sole owner, the amount of the home loan interest paid referred to in paragraph (a)(i) shall be regarded as having been paid -*

(i) *where the dwelling is held by the person as a joint tenant, by the joint tenants each in proportion to the number of the joint tenants; or*

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- (ii) *where the dwelling is held by the person as a tenant in common, by the tenants in common each in proportion to his or her share in the ownership in the dwelling.*

...

- (3) (a) *Where any home loan interest is paid by a person during any year of assessment for the purposes of a home loan obtained in respect of a dwelling which is used at any time in that year of assessment by that person exclusively or partly as his place of residence, but the loan was not applied wholly for the acquisition of the dwelling, the deduction allowable to the person under subsection (1) for that year of assessment in respect of the home loan interest paid shall be such part of the amount of the home loan interest paid as is reasonable in the circumstances of the case.*

...

- (9) *In this section -*

“dwelling” (住宅) means any building or any part of a building –

- (a) *which is designed and constructed for use exclusively or partly for residential purposes; and*
- (b) *the rateable value of which is separately estimated under section 10 of the Rating Ordinance (Cap. 116);*

“home loan” (居所貸款), in relation to a person claiming a deduction under this section for any year of assessment, means a loan of money which is –

- (a) *applied wholly or partly for the acquisition of a dwelling which -*
 - (i) *during any period of time in that year of assessment is held by the person as a sole owner, or as a joint tenant or tenant in common; and*
 - (ii) *during that period of time is used by the person exclusively or partly as his place of residence; and*

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(b) *secured during that period of time by a mortgage or charge over that dwelling or any other property in Hong Kong;*

“home loan interest” (居所貸款利息), in relation to a person claiming a deduction in respect of a dwelling under this section, means interest paid by the person as a sole owner, or as a joint tenant or tenant in common of the dwelling for the purposes of a home loan to –

(a) *the Government;*

(b) *a financial institution;*

(c) *a credit union registered under the Credit Unions Ordinance (Cap. 119);*

(d) *a money lender licensed under the Money Lenders Ordinance (Cap. 163);*

(e) *the Hong Kong Housing Society;*

(f) *an employer of the person; or*

(g) *any recognized organization or association;’.*

8. Schedule 3D to the IRO specifies the maximum amount of home loan interest allowable to a person during any year of assessment :

‘ 1. For the years of assessment 1998/99 to 2000/01 inclusive \$100,000

2. For the years of assessment 2001/02 and 2002/03 \$150,000’

9. No problem arises out of the fact that the Property was registered in the name of the Spouse because under section 26F of the IRO a person may nominate his or her spouse to claim deduction.

10. The question of limitation for additional assessments is dealt with under section 60 of the IRO subsection (1) of which reads as follows : -

‘ 60. Additional assessments

(1) Where it appears to an assessor that for any year of assessment any person chargeable with tax has not been assessed or has been

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assessed at less than the proper amount, the assessor may, within the year of assessment or within 6 years after the expiration thereof, assess such person at the amount or additional amount at which according to his judgment such person ought to have been assessed, and the provisions of this Ordinance as to notice of assessment, appeal and other proceedings shall apply to such assessment or additional assessment and to the tax charged thereunder :

Provided that –

(a) (Repealed 2 of 1971 s. 39)

(b) where the non-assessment or under-assessment of any person for any year of assessment is due to fraud or willful evasion, such assessment or additional assessment may be made at any time within 10 years after the expiration of that year of assessment.’

11. Section 68(4) of the IRO reads as follows:

‘(4) The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.’

Our conclusion

12. We have considered all the evidence and have come to the view that it cannot be said that Loan 2, Loan 3 and Loan 4 were obtained or obtained **wholly** ‘for the acquisition of a dwelling’ within the meaning of section 26E of the IRO. We believe also that the Taxpayer is not seriously contending that they were.

13. The position of the Taxpayer is no different from that in the cases decided by the Board in Cases Nos D22/01, IRBRD, vol 16, 220, D123/01, IRBRD, vol 16, 915 and D18/02, IRBRD, vol 17, 483 cited to us.

14. We have come to the conclusion that the assessments made and the concessions granted by the Inland Revenue Department to the Taxpayer are reasonable. To put it another way, we are not persuaded by the Taxpayer that the assessment for additional salaries tax for the year of assessment 2001/02 raised on the Taxpayer is unreasonable or excessive.

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15. In all the circumstances, although we have a certain amount of sympathy for the Taxpayer because he had been misled by the conduct on the part of the Inland Revenue Department for a period of time, we have no alternative but to dismiss the Taxpayer's appeal.