

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D33/97

Salaries tax – whether housing assistance paid to taxpayer by employer was rental refund or cash allowance – taxpayer residing with his parents – ‘lease agreements’ entered into by taxpayer – agreements not submitted for stamp duty – whether landlord and tenant relationship existed – whether control exercised by employer over payment of housing assistance – Inland Revenue Ordinance sections 8(1) and 9(1)(b), (1)(c), (1A) and (2); Stamp Duty Ordinance (Chapter 117) section 15(1) and First Schedule, head 1(2).

Panel: Andrew Halkyard (chairman), David A Morris and William Zao Sing Tsun.

Date of hearing: 13 May 1997.

Date of decision: 10 July 1997.

During the year ended 31 March 1995, the taxpayer purported to enter into lease agreements with his parents concerning two properties. His parents, the Taxpayer and his sister resided in Property A for the first half of the year. Property A was owned by his parents. His parents, the taxpayer and his sister resided in Property B for the second half of the year. Property B was owned by the taxpayer and his mother. The lease agreements were not submitted to the Stamp Office for payment of stamp duty. Receipts for payment of ‘rent’ were, however, signed by the taxpayer’s mother and given to the taxpayer. Property tax returns were submitted to the Inland Revenue Department by the respective owners of Property A and Property B disclosing rental income purportedly paid by the taxpayer. Property tax assessments were issued to the owners.

During the year ended 31 March 1995, the taxpayer’s employer paid an amount to the taxpayer described as ‘housing assistance’. The employer stated that it did not possess a copy of the lease agreements entered into by the taxpayer. Furthermore, the employer made no attempt to reconcile the amount paid as housing assistance with the amounts purportedly paid as rent by the taxpayer to his parents as set out in the receipts.

The issues for determination by the Board were as follows:

- (1) Whether a landlord and tenant relationship existed between the taxpayer and his parents in relation to Property A and Property B; and
- (2) Whether the amount of ‘housing assistance’ received by the taxpayer from the employer was a rental refund (which would be subject to tax at a beneficial rate) or a cash allowance not amounting to a rental refund (which would be fully subject to tax).

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Held:

- (1) The whole tenor of the taxpayer's evidence was that in entering into the agreements with his parents there was simply no intention on the part of both parties to enter into legal relations. In essence what was achieved was a non-binding family or social arrangement. Objective support for this conclusion were the facts that the agreements, not being stamped, could not be enforced in any court or tribunal in Hong Kong without being stamped (they were thus not admitted in evidence before the Board); the absence of evidence relating to the normal indicia of a landlord and tenant relationship; and the discrepancies between the amounts claimed by the employer as 'housing assistance' and the different figures given to the employer by the taxpayer at different times as to the amount of rent claimed to be paid by him. In all the circumstances, the overwhelming conclusion was that, as a matter of law, no legal relationship of landlord and tenant was ever created between the taxpayer and his parents. It is not enough for the taxpayer simply to reply upon the formal niceties of paying cheques to family members, issuing receipts and completing property tax returns. The amount in dispute could not be classified as a refund of 'rent'.
- (2) In any event, proper controls were not exercised by the employer over the so-called housing assistance paid to the taxpayer. Copies of the lease agreements were not in the employer's possession and the employer made no attempt to reconcile the amount of rent claimed to have been paid by the taxpayer with the amount set out in the 'rent receipts'. The amount in dispute was a cash allowance which did not amount to a rental refund.

Appeal dismissed.

Cases referred to:

D16/93 (1993) 1 HKRC 80-254

D92/95, IRBRD, vol 11, 173

D19/95, IRBRD, vol 10, 157

Fung Chi Keung for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

This is an appeal against an assessment to salaries tax for the year of assessment 1994/95. The Taxpayer claims that an amount included in the assessment as a cash allowance should be treated as a rental refund and thus subject to the beneficial treatment accorded to rental refunds under the Inland Revenue Ordinance (the IRO).

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The facts

The basic facts, which have essentially been agreed by both parties, are as follows.¹

1. The Taxpayer was employed by an audit firm ('the Employer') as an Audit Assistant in 1989. He was promoted to Assistant Manager on 1 January 1994 with monthly salary and housing assistance of \$25,000 and \$5,000 respectively. His contract of employment stated, inter alia:

'Housing Assistance

You will receive \$5,000 per month as housing assistance, payable in arrears. You are required to comply with the current policy and procedure concerning accommodation costs and the filing of your salaries tax return, details of which are held by Staff Department.'

2. The Employer filed an employer's return in respect of the Taxpayer for the year ended 31 March 1995 showing, inter alia, the following particulars:

(a) Capacity in which employed : Audit Assistant Manager

(b) Period of employment : 1-4-1994 to 31-3-1995
)

(c) Income : Salary \$313,500

Bonus 25,000

Overtime allowance 13,250

Total \$351,750

(d) Quarters provided
)

	Rent paid to Landlord by employee	Rent refunded to employee by employer
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Period provided

1-4-1994 to 31-3-1995	<u>\$124,080</u>	<u>\$82,500²</u>
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¹ The only matters to which the Taxpayer demurs are facts 6(a) and (b) where the Taxpayer maintains that, contrary to the Employer's assertion, he was not paid a fixed cash allowance and he submitted rental receipts to the Employer during the year of assessment. We deal with these issues below.

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3. In his individuals tax return for the year of assessment 1994/95, the Taxpayer declared the same income as shown in fact 2(c) above and claimed a dependent parent allowance, an additional dependent parent allowance and a dependent grandparent allowance. He declared the following particulars for quarters provided by the Employer:

	Nature of quarters	Period provided	Rent paid to landlord	Rent refunded by employer
Property A	Flat Property A	1-4-1994 to 30-9-1994	\$54,720	\$37,500
Property B	Flat Property B	1-10-1994 to 31-3-1995	\$69,360	\$45,000

4. On 4 August 1995 the assessor raised the following salaries tax assessment for the year of assessment 1994/95 on the Taxpayer:

	\$
Income	351,750
Quarters	<u>35,175</u>
	386,925
<u>Less: Charitable donations</u>	<u>500</u>
	386,425
<u>Less: Allowances</u>	<u>115,000</u>
Net chargeable income	<u>271,425</u>
 Tax payable thereon	 <u>46,485</u>

5. The Taxpayer objected to the assessment in the following terms:

‘The value of the quarter should be zero as the rent paid by me to the landlord less the rent refunded to me by my employer exceeds the 10% of the income from my employer.’

6. In response to the assessor’s enquiries, the Employer provided the following information and documents:

- (a) ‘Grades of Assistant Manager and above receive a fixed cash allowances as a rental allowance, the amount of which is based on their grades ... The rental allowance paid to [the Taxpayer] effective 1 January 1994 on promotion to Assistant Manager was a cash allowance.’

² Calculated as follows: April-June 1994: \$5,000 per month × three months plus July 1994 to March 1995: \$7,500 per month × nine months (fact 6(d) refers).

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- (b) 'Each financial year end, it was our Firm's practice to request the staff graded Supervisors and above to submit the details paid together with a copy of lease agreements and management fee invoices for the completion of employer's return ... Copies of both [the Taxpayer's] tenancy agreements and rental receipts are outstanding. [The Employer] took [the Taxpayer's] word in good faith and presumed the documents would be forthcoming. [The Employer] continued to press [the Taxpayer] for the production of these documents both during his employ and on his resignation, effective 1 August 1995.'
- (c) A copy of the Employer's Rental Paid Advice' which required the Taxpayer to complete the details of rent paid to enable the completion of the employer's return for the year ended 31 March 1995. The document showed the following details:

'Please confirm that a copy of the lease agreement has been submitted to Staff Dept. Your signature below will be taken as your confirmation that this has been done.

Property B

Rent	:	$\$7,800 \times 6 + \$12,000 \times 6 = \$118,800$
Rates	:	[nil]
Other charges	:	\$5,280
Annual total	:	\$124,080

(The amount will equate to that which you have submitted to Staff Department. As part of our procedures this advice will be forwarded to Staff Dept for checking.)'

The document was signed by the Taxpayer on 31 March 1995. Subsequently, staff of the Employer noted the following details on the form:

'Rent subsidy : \$82,500'

- (d) The rental allowance described above had been increased from \$5,000 per month to \$7,500 per month with effect from July 1994.³

7. In response to the assessor's enquiries, the Taxpayer confirmed that the owners of Property A were his parents and that the owners of Property B were the Taxpayer and his mother. He also provided copies of the following documents:

³ The increase in 'housing assistance' was made available to all staff of the Employer having the same grade as the Taxpayer.

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- (a) Undated and unstamped tenancy agreements signed by the Taxpayer as tenant and by his mother as landlord in respect of:
 - (i) Property A for the period from 1 April 1994 to 1 December 1994 at a monthly rental of \$8,800; and
 - (ii) Property B for the period from 1 October 1994 to 31 July 1995 at a monthly rental of \$11,000.
- (b) Twelve rental receipts signed by the Taxpayer's mother in respect of Property A for the period from April 1994 to September 1994 and Property B for the period from October 1994 to March 1995. The Taxpayer explained that the tenancy agreements in (a) above were not stamped 'given the close relationship between the landlords and the tenant'.

Evidence of the Taxpayer

The Taxpayer elected to give sworn evidence before the Board. On the basis of that evidence and various documents produced before us, we make the following additional findings of fact.

Property A

8. At all relevant times Property A was owned by the Taxpayer's parents, Mr C and Mrs C, as joint tenants. Property A was constructed in 1963 and was purchased by the Taxpayer's parents in 1984. The Taxpayer lived with his parents in Property A in 1984 but thereafter until 1989 he was studying at University and did not live with them at all times. During this period he did not earn any salary and he did not pay any rent to his parents.

Property B

9. Property B was purchased by the Taxpayer and his mother, Mrs C, in January 1993 as joint tenants for a consideration of \$2,550,000. The Taxpayer and his family occupied Property B as their residence with effect from October 1994. To finance the purchase a mortgage was taken out by the Taxpayer and Mrs C. The monthly mortgage payment amounted to \$16,000.

10. At all relevant times Mrs C was a housewife. The Taxpayer agreed that she used the money paid to her by the Taxpayer (fact 14 refers) to finance the monthly mortgage payment referred to at fact 9.

The Taxpayer's dealings with the Employer

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11. The Taxpayer stated that, contrary to the Employer's statement at fact 6(b), he did submit rental receipts⁴ to the Employer. He could not remember whether he submitted the lease agreements to the Employer.

12. The Taxpayer admitted that he made a mistake in filling out the 'Rental Paid Advice' described at fact 6(c) and that this was due to his not checking the tenancy agreements and rental receipts. He claimed that the correct rental payments made in 1994/95 were set out at fact 14 below under the heading 'Receipt'.

The Taxpayer's dealings with his parents

13. To support his claim that he paid rent in respect of Property A and Property B during the year of assessment 1994/95, the Taxpayer produced copies of a series of cheques drawn by him in favour of Mrs C and receipts signed by Mrs C. The receipts were all of an identical pre-printed nature. None of the receipts was numbered and none recorded the name of the payer. The receipt for July 1994 was unsigned. The Taxpayer could not explain these matters other than to state that he simply accepted them because they were given to him by his mother. Apart from recording the address of the relevant property, various substantive lease terms were purportedly recorded in the receipts. For example, it was stated that:

- '(1) It is agreed that the rent shall be paid in advance each month and no delay will be allowed ...
- (2) If the tenant wants to move out, the tenant shall give a written notice one month in advance according to the tenancy agreement. Otherwise, a month's rent shall be paid as compensation in accordance with the laws of Hong Kong.'

14. The following is summary of the amounts claimed by the Taxpayer to be rental payments:

Month	Cheque \$	Receipt \$	Date of cheque	Date of receipt	Mortgage payment ⁵ \$	Others ⁶ \$
April	10,000	8,800	7-4-1994	1-4-1994 ⁷	-	1,200

⁴ See further facts 13 and 14.

⁵ See also fact 9. Under the terms of the mortgage, Mrs C and the Taxpayer were jointly and severally liable to the mortgagee.

⁶ The Taxpayer acknowledged that in no month did the cheques drawn by him correspond to the amount of rent claimed to have been paid by him. He claimed that the excess payments were made to cover household expenses such as management fee and utilities. When questioned why household expenditure dropped when the family moved to the newer Property B the Taxpayer admitted that the excess payments were rough approximations and were not worked out precisely.

⁷ The Taxpayer could not explain why the receipt for April 1994 *pre-dated* the cheque other than to say that Mrs C may have written down the wrong date.

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May	10,000	8,800	2-5-1994	3-5-1994	-	1,200
June	10,000	8,800	1-6-1994	1-6-1994	-	1,200
July	(cash) ⁸	8,800	-	8-7-1994	-	1,200
August	10,000	8,800	5-8-1994	5-8-1994	-	1,200
Sept ⁹	25,219	8,800	29-9-1994	29-9-1994	-	5,419
Oct	}	11,000	}	}		}
Nov	20,000	11,000	2-11-1994	2-11-1994	8,000	1,000
Dec	20,000	11,000	27-12-199	28-12-1994 ¹⁰	8,000	1,000
4						
Jan	20,000	11,000	3-1-1995	5-1-1995	8,000	1,000
Feb	20,000	11,000	6-2-1995	6-2-1995	8,000	1,000
March	20,000	11,000	6-3-1995	6-3-1995	8,000	1,000

15. In relation to the year of assessment 1994/95, the respective owners of Property A and Property B submitted property tax returns to the Inland Revenue Department showing rental income respectively of \$52,800 (that is, \$8,800 per month × six months) and \$66,000 (that is, \$11,000 per month × six months). Property tax assessments were issued by the assessor to the owners in respect of these returns.

16. In response to a question from the Board, the Taxpayer provided the following background to the alleged lease agreements he entered into with his parents:

[When I became qualified under my contract of employment with the Employer] I was entitled to a housing allowance. If I spent it, I would have a tax benefit; if not, I would not get a tax benefit. [I was living at home with my parents] and I discussed this with them and we agreed to enter into a lease agreement. We talked about legality [that is, whether it was possible for parents and their children to enter into a lease agreement], reasonable rent, and

⁸ The Taxpayer thinks, but does not know precisely, that he made the July 1994 payment of \$10,000 by cash.

⁹ On 20 September 1994 the Taxpayer drew a cheque in favour of a stock broker, in the amount of \$25,219. Mrs C has an account with this stock broking company. The Taxpayer claims that the rental payment for September and October 1994 (total \$19,800) was satisfied by his discharging Mrs C's liability to this stock broking company. The Taxpayer claims to have made this payment late in the month because he was away from Hong Kong on a business trip. He acknowledged that the face value of the cheque was more than two month's 'rent' and that Mrs C should have (but presumably did not) repaid some amount to him. The Taxpayer acknowledged that a tenant should pay rent on time, but that he did not have to do this because the payments were made to his mother.

¹⁰ The Taxpayer could not remember why he made a late payment in December 1994. He thought that this may have been due to a cash flow problem but reiterated that, in any event, he need not pay on the exact date because the payment was made to his mother.

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that I would pay them. I can't remember whether we discussed any rights of landlord and tenant. If they leased property to me they should move out of the property. I never thought about that point.

My family has four members: my parents, my sister and myself. Both Property A and Property B have three bedrooms. My parents occupied one room, my sister occupied one room and I occupied one room. The privacy of family members is respected. If the door was closed, I would not enter another member's room unless given permission. I would not just walk in and take what I wanted. All family members acted in this way.

Issues before the Board

The Board commends both parties for their respective arguments which were put clearly and simply. The issues raised by both parties in relation to the year of assessment 1994/95 were as follows:

- (1) Whether the amount of 'housing assistance' received from the Employer (facts 1 and 2 refer) was a rental refund or simply a cash allowance which did not amount to a rental refund; and
- (2) Whether a landlord and tenant relationship existed between the Taxpayer and his parents in relation to Property A and Property B.

The Taxpayer's contentions

1. Cash allowance v rental refund

The Taxpayer argued that the distinction between a cash allowance and a rental refund is that the former is fully taxable because it can be spent in whatever way the recipient wishes. In the present case, however, the Taxpayer submitted that the Employer was concerned and did impose controls over the way he spent the sum in dispute; that he did spend money on housing; and, therefore, the housing assistance received from the Employer must be a rental refund.

As noted above, and contrary to the Employer's statement at fact 6(a), the Taxpayer claimed that the housing assistance was not a fixed cash allowance. The Taxpayer pointed out that the Employer had also acknowledged to the assessor that he was paid a rent refund (fact 2 refers) and this reinforced his argument that the Employer's statement at fact 6(a) should not be taken at face value.

2. Landlord and tenant relationship

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The Taxpayer acknowledged that the alleged lease agreements prepared by him were not stamped and were, therefore, inadmissible in evidence.¹¹ None the less, he argued that this did not preclude a landlord and tenant relationship existing between himself and his parents. To bolster his argument the Taxpayer pointed out that during the year of assessment 1994/95 he paid rent to his parents, receipts were issued by Mrs C (fact 13 refers) and that the respective owners of Property A and Property B submitted property tax returns to the Inland Revenue Department and these were properly assessed (fact 15 refers). He did not accept the Commissioner's contention that he had merely entered into a non-binding family arrangement with his parents.

The Taxpayer also noted that a parent is not legally prohibited from entering into a lease with his or her child. In the Taxpayer's view, his arguments are not affected by the fact that, at all relevant times, his parents (in their capacity as landlords) lived with him in the same property or that, in relation to Property B, he was a co-owner: compare D16/93 (1993) 1 HKRC 80-254 a case where an employee leased a self-owned property to his employer which then allowed him (that is, the landlord) to reside in the property. In relation to Property B the Taxpayer argued that his agreement with Mrs C was simply to lease her 50% interest in the property.

The Commissioner's contentions

The Commissioner's representative, Mr Fung Chi-keung, handed to the Board a written submission. Given our view of the facts before us it is not necessary to set out Mr Fung's submissions in detail. Suffice to say that he took issue with the Taxpayer on both issues arguing (1) that no landlord and tenant relationship existed between the Taxpayer and his parents and (2) that, in any event, the Employer was unable to exercise sufficient control over the way in which the amount in dispute was spent, thus leading to the conclusion that this amount was simply a cash allowance and not a rental refund.

Analysis

Having considered all the facts before us, we uphold the determination of the Commissioner. Notwithstanding the Taxpayer's able arguments, which he put with clarity and force, the fact remains that the whole tenor of his evidence was that in entering into agreements with his parents there was simply no intention on the part of both parties to enter into *legal* relations.

This can first be shown by reiterating the Taxpayer's evidence set out at fact 16: although he took pains to consider the legality of what he wished to do, in essence what was achieved was a non-binding family or social arrangement. At no time did the Taxpayer ever indicate in his evidence before us that he and his parents intended entering into a binding agreement, having legal force and creating mutual rights and obligations.

¹¹ See head 1(2) of the First Schedule and s 15(1) of the Stamp Duty Ordinance.

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The above conclusion can also be objectively supported. The Taxpayer knew well before this Board hearing that the purported lease agreements should, if indeed they were leases, be subject to stamp duty. They were never submitted for stamping. He was also aware that the unstamped agreements could not be introduced in evidence before us if they were the proper subject of stamp duty. Most importantly, the Taxpayer was aware that his rights and obligations as a tenant and those of his parents as landlord could not be fully enforced in any court or tribunal in Hong Kong without stamping. Yet, notwithstanding all this, for reasons only known to himself, the Taxpayer chose not to stamp those agreements. This clearly supports the conclusion that, in this case, there was never any intent on the part of the Taxpayer and his parents to enter into legal relations.

We have also considered the normal indicia of a landlord and tenant relationship: such as the tenant's outgoings (rates, management fees and charges), and obligations (such as tenant's repairs and insurance). Although these may have been the subject of the unstamped agreements (and we are in no position to speculate on this matter), they were simply not referred to at all in the Taxpayer's evidence apart from a possible inference that may be drawn from fact 14, note 6 above. But an equal, if not stronger, inference is that the amounts designated as 'Other' payments in fact 14 were simply contributions to household expenses made by a salary-earning family member. In the event, the Taxpayer has not satisfied us that these payments represented normal tenant's outgoings and obligations.

When the above matters are combined with facts such as the claimed confusion over the incorrect 'Rental Paid Advice', the incorrect rental figures contained in the Taxpayer's individuals tax return, and the various matters set out in fact 14, notes 6 – 10, the overwhelming conclusion in this case must be that, as a matter of law, no legal relationship of landlord and tenant was ever created between the Taxpayer and his parents. It must follow that the amount in dispute cannot be classified as a refund of 'rent'.

Even if we doubted the above conclusion (which we do not), we would also find that the amount in dispute was simply a cash allowance. The Taxpayer argued to the contrary, contending that the Employer *was* concerned with the way in which the amount was spent. The fact remains however that, in the Taxpayer's case, the amount was simply paid to him without those controls being properly exercised. Granted that the Taxpayer submitted to the Employer a statement entitled 'Rental Paid Advice'. But this is simply a means to an end and not the end itself: if any control were exercised, copies of the lease agreements would have been in the Employer's possession (they were not: fact 6(b) refers) and queries should have been made regarding the discrepancy between the amount of rent claimed by the Taxpayer in the 'Rental Paid Advice' and that set out in the receipts, copies of which were, the Taxpayer claims, submitted to the Employer (such queries were not made).

Notwithstanding the tenor of our decision, we feel some sympathy for the Taxpayer in this case. Amongst other things, he points out that (apparently) the Commissioner accepts rental benefit arrangements whereby an employee who is a homeowner can lease his or her property to the employer and still remain living in the

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property. This is but one example of a very beneficial policy adopted by the Commissioner in the whole area of assessing rental benefits. The Taxpayer doubtless felt somewhat aggrieved that he also should have the benefit.

However, as this decision indicates, that benefit cannot be obtained where, in a case involving an alleged rental refund, as a matter of law no relationship of landlord and tenant existed. It is not enough simply to rely (as in this case) upon the formal niceties of paying cheques to a family member, issuing receipts and completing property tax returns.

Furthermore, even if this threshold question were overcome, where a place of residence is not provided by the employer, any sum received by an employee for housing assistance (to use a neutral term) must be capable of being classified as rental refund if it is to be assessed at the beneficial rate set out in section 9(1)(b), (1)(c), (1A) and (2) of the IRO. At this juncture it is relevant to note that the salaries tax advantages of housing assistance being assessed under these provisions is well known. Equally well known is the Commissioner's pragmatic policy in administering these provisions (see D92/95, IRBRD, vol 11, 173). But, in order to achieve the desired benefit, it must be clear to both employers and employees alike that simply designating an allowance as a rental benefit will not necessarily achieve that objective.

A 'refund' of rent connotes a repayment or reimbursement, not mere payment (see D19/95, IRBRD, vol 10, 157). This means, in the typical case, that sufficient control must, as a matter of fact (and not just in theory), be exercised by the employer over the payment so that the allowance is effectively a refund of rent and not just an additional emolument to be spent in any way that an employee may desire. Where, as is apparent from this case, an employee has acted in a way such that the employer's system of control cannot operate in the manner for which it was designed (for example, by the employee's failure to submit to the employer a lease agreement or rental receipts for verification), it ill-behooves the employee to then argue that a payment received from the employer *must* be a refund simply because rent was, in the event, paid by the employee. Conversely, if no system of employer control exists to verify that a payment made to an employee was a refund of rent, this is simply a cash allowance. In neither case would the payment in law amount to a rental refund for salaries tax purposes.

It is trite to state that the Hong Kong salaries tax treatment of rental refunds is generous, easily complied with and pragmatically administered. But it *is* necessary to reiterate that employees and employers must appreciate that, as a general matter, both must play their part in ensuring that employees obtain the desired taxation benefits.

For all the above reasons the appeal is dismissed and the assessment in dispute confirmed. It follows from this decision that the property tax assessments raised upon the respective owners of Property A and Property B for the year of assessment 1994/95 should be annulled.