

# INLAND REVENUE BOARD OF REVIEW DECISIONS

## Case No. D34/96

**Salaries tax** – section 9(1A)(a) – whether part of the commission labelled reimbursement for rental is taxable.

Panel: Audrey Eu Yuet Mee QC (chairman), Andrew Chan Weng Yew and Felix Chow Fu Kee.

Date of hearing: 23 July 1996.

Date of decision: 13 August 1996.

### **Appeal dismissed.**

Case referred to:

D19/95, IRBRD, vol 10, 157

John Smith for the Commissioner of Inland Revenue.

Neil Thomas for the taxpayer.

### **Decision:**

#### **A. APPEAL**

A.1 The Taxpayer appeals against the determination of the Commissioner of Inland Revenue dated 9 October 1995 against the salaries tax assessment for the years of assessment 1991/92 and 1992/93.

A.2 The issue turns on whether certain payments to the Taxpayer should be deemed not to be income and exempt from tax under section 9(1A)(a) of the Inland Revenue Ordinance chapter 112 (the IRO).

#### **B. AGREED FACTS**

B.1 The following facts set out in this section are agreed.

B.2 The Taxpayer had worked for Company A for many years. On 1 January 1989, he became employed by Company A Asia branch in Hong Kong. Contrary to paragraphs 14(a) of the determination, he was not seconded from Country B. Thus his terms of employment was a matter between him and the Hong Kong company.

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B.3 During the material period, the Taxpayer resided at Flat C. The lease was in his wife's name. She was working for Country D Consulate until 1 September 1992. She was not paid any reimbursement, allowance or assistance in respect of the accommodation.

B.4 The Taxpayer was employed on a commission only basis. His earnings was computed by reference to the volume of business generated by his activities. He was responsible for his own expenses.

### C. THE DISPUTE

C.1 The Inland Revenue says the tax position should be as follows:

1991/92		\$
Gross Income		381,337
Expenses		120,112
<u>Less:</u> Married Person's Allowance	]	
	]	96,000
Child Allowance	]	_____
Net Chargeable Income		165,225
Tax thereon		31,906 =====
1992/93		
Gross Income		463,391
Expenses		138,665
<u>Less:</u> Married Person's Allowance	]	
	]	107,500
Child allowance	]	_____
Net Chargeable Income		217,226
Tax thereon		44,906 =====

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- C.2 The Taxpayer says that part of the gross income should be refund for rent under section 9(1A)(a) and only the surplus, after deducting the rent refund, was taxable. The position as contended by him is as follows:

1991/92	\$
Gross Income	80,137
Expenses	<u>120,112</u>
Net Chargeable	NIL
1992/93	
Gross Income	126,191
Expenses	<u>138,665</u>
Net Chargeable	NIL

- C.3 The difference is arrived at in this way. For the year of assessment 1991/92, the difference between the Revenue's figure of \$381,337 and the Taxpayer's figures of \$80,137, that is, \$301,200 was said to be rent refund for the year. For the year of assessment 1992/93, the difference between \$463,391 and \$126,191, that is, \$337,200 was said to be rent refund for that year.

- C.4 We should add that there is some difference in the figures put forward by the Taxpayer and his then employers. According to the return and the information supplied by the employer, the rent refund should not exceed 40% of the commission income. Thus for the year of assessment 1992/93, the employer had returned the total income of \$463,391 divided into \$191,597 for quarters and \$271,794 commission income.

- C.5 We noticed that in his submission to the Board, the Taxpayer's counsel provided figures for the net assessable income and the tax payable different from those stated above. We found that the figures provided were erroneous. We should further add that the computations contended by the Taxpayer have omitted the rental value as income per section 9(1)(a). However, we shall ignore this part as it is irrelevant to the conclusion of this case.

### **D. THE TAXPAYR'S EVIDENCE**

- D.1 The Taxpayer is no longer working for the same employer. He was out of Hong Kong and was represented at the hearing by his counsel Mr Thomson.

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D.2 The Taxpayer did not call any witness. He put in two affidavits, one from himself and one from Mr E who was then the managing director of Company A Asia branch. The Inland Revenue did not object to these affidavits.

D.3 The Taxpayer explained in his affidavit that from 1 January 1989, he was to be paid entirely on a commission basis. No housing benefit was provided. It rapidly became apparent that the high cost of housing in Hong Kong made the terms of his employment impractical. He took professional advice and was advised to reach a new agreement with his employers so that they would reimburse him for his rental. His taxable housing benefit would then be only 10% of his net income after deduction of the rental reimbursement.

D.4 Pursuant to such advice, he entered into a new agreement with his employer. He relies on a letter dated 7 June 1989 signed by Mr E whereby his employment was said to be varied with effect from 1 January 1989. The agreement provides:

- ‘1. You will be reimbursed up to US\$32,692 (HK\$255,000) per annum to cover the cost of rented residential accommodation in Hong Kong. The reimbursement will only be made on production of satisfactory receipts evidencing your expenditure.
2. Your cash remuneration will consist of commission at the rate of 30% in respect of gross commissions produced, to the extent that such commission exceeds US\$32,692 per annum, payable monthly in arrears.’

This was followed by a similar letter dated 2 January 1990 for the following year:

- ‘1. You will be reimbursed up to US\$38,154 (HK\$297,600) per annum to cover the cost of rented residential accommodation in Hong Kong. The reimbursement will only be made on production of satisfactory receipts evidencing your expenditure.
2. Your cash remuneration will consist of commission at the rate of 30% in respect of gross commissions produced, to the extent that such commission exceeds US\$38,154 per annum, payable monthly in arrears.’

and another letter dated 2 January 1991 which reads:

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- ‘1. You will be reimbursed up to US\$38,769 (HK\$302,400) per annum to cover the cost of rented residential accommodation in Hong Kong. The reimbursement will only be made on production of satisfactory receipts evidencing your expenditure.
2. Your cash remuneration will consist of commission at the rate in accordance with the commission pay-out scale in force, to the extent that such commission exceeds US\$38,769 per annum, payable monthly in arrears.’

D.5 Every month since April 1991, the Taxpayer received \$15,000. In addition, he received another payment quarterly during the year. At the end of the year, he produced rental receipts and management fee receipts to his employer and an adjustment was made so that he would be paid the balance of his commission after deducting what has already been paid.

D.6 It was explained that the monthly \$15,000 was paid on account of rent reimbursement and earnings. It was understood that the agreement was conditional upon the Taxpayer providing rental receipts on a regular basis and if the earnings should not cover the rental expenses, the Taxpayer was to make good the difference.

D.7 It was further explained that the lease was in the wife’s name as she was a consular officer and enjoyed exemption from rates. The Taxpayer produced a few pages of his bank account which showed that the monthly \$15,000 was paid into this account and the rental and management fees were paid out of this account.

### **E. THE LAW**

E.1 The law is set out in the relevant sections of the IRO.

E.2 Section 8 charges the Taxpayer to salaries tax on income from employment. Section 9 defines income from employment and section 9(1)(a) includes ‘commission’. Notwithstanding section 9(1)(a), section 9(1A)(a) provides that refunds of all payment of the rent paid by the employee shall be deemed not to be income. The issue is whether the amounts contended by the Taxpayer falls within the refund of all or part of the rent paid by the employee within the meaning of section 9(1A)(a) or not.

E.3 Most of the cases cited by the parties deal with whether a payment was rental allowance which is income or rental refund which is deemed not to be. That is not the issue in this case.

### **F. REASONS FOR DECISION**

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- F.1 We are satisfied that the Taxpayer and his then employer bona fide entered into an arrangement intending to take advantage of the tax benefit under section 9(1A)(a).
- F.2 There is some concern that the lease was in the name of the Taxpayer's wife. Prima facie this was her liability rather than the Taxpayer's. The Taxpayer said that it was he and not his wife who paid the rent and management fees and he produced some documents in support. Mr Smith for the Revenue reminded us that the burden was on the Taxpayer yet he did not give evidence nor produce documents to show conclusively he made all the payments. We are satisfied that, at the end of the day, it is difficult if not impossible to decide, as between husband and wife, whose liability it was and who made the payment. Nothing turns on this point.
- F.3 The situation is actually very simple. It is as stated in paragraph 3C of the written submission made on behalf of the Taxpayer. We have already set out part of that submission in paragraph B4 above.
- ‘(The Taxpayer) was employed on a commission only basis. His earnings were computed by reference to the volume of business generated by his activities. He was responsible for his own expenses ...’
- And those expenses, for which he was responsible, included his rent. In the submission, Mr Thomson referred to \$381,337 as the gross income for the year of assessment 1991/92 and \$463,391 as the gross income for the year of assessment 1992/93.
- F.4 Consistent with that arrangement, both the Taxpayer and Mr E said in their affidavits that if the Taxpayer's earned commission fell below the rental expenses, the Taxpayer was responsible for the shortfall. Conversely, if the Taxpayer did not incur any rental expenses and thus produced no rental receipts, he would still be paid the same amount. This is not a case of two parties agreeing on an employment package comprising of two components, one being rent refund and the other being commission. This is a case of two parties agreeing on an employment package comprising of only one component, namely commission and then agreeing at the end of the year, depending on the commission earned, to label part of that component rent refund and the balance commission. In fact, the whole amount was, from beginning to end, commission earned based on an agreed percentage or a commission pay-out scale.
- F.5 The Taxpayer relies on D19/95, IRBRD, vol 10, 157 where the taxpayer tried to argue that the housing allowance paid to him was in substance a rental refund, even though it was not so in form. That is not authority for the

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proposition that substance does not matter or that it is merely a matter of the label attached to the payment. In this case, we are not satisfied that, by the arrangement the parties have entered into, they have effectively converted what is in effect commission and therefore taxable income into rent refund within the meaning of section 9(1A)(a) of the IRO.

F.6 For the above reasons, the appeal is dismissed and we affirm the assessment as set out in paragraph C.1 above.

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### **Addendum**

Subsequent to the decision, Counsel for the Taxpayer wrote with reference to paragraph C5 above to the effect that while the figure for tax payable submitted by him was in error, the figures provided by him correctly showed the gross remuneration and expenses and correctly left out the rental value as acceptance of the Taxpayer's contention would have resulted in a nil tax charge. The section 9(1)(a) charge would have had no effect on the final assessment of tax payable.