Case No. D38/08

Salaries Tax – deductions – ‘home loan interest’ – re-financing of mortgage – section 26E of the Inland Revenue Ordinance (‘IRO’).

Panel: Benjamin Yu SC (chairman), Felix Chan Wai Hon and Chris Mong Chan.

Dates of hearing: 20 December 2007 and 6 June 2008.
Date of decision: 6 November 2008.

On or about 15 July 1999, the taxpayer and her husband purchased a property from Organization C. The purchase was financed by two mortgages, namely, a first mortgage with Bank A in the sum of HK$950,000 and a second mortgage with Organization C in the sum of HK$467,600 (“the Organization C loan”). On 14 July 2004, the taxpayer and her husband repaid the Organization C loan. In the meantime they applied to Organization C for an assessment of premium to release them from a restriction against alienation. It was not until 20 July 2004 that they were informed that the premium was assessed at HK$641,000. On 15 September 2004, the couple obtained a second loan from Bank A in the sum of HK$1,122,336.27 (“the second bank loan”). The second bank loan was primarily used to repay the first loan with Bank A and the premium payable to Organization C.

The taxpayer and her husband gave evidence to the effect that the repayment of the Organization C loan was made out of sheer expediency and they had all along intended to take out the second bank loan to replace the Organization C loan. They explained that the latter loan must be repaid on 14 July 2004 so that a waiver of 5% charge could be obtained and that an earlier repayment to Bank A would be subject to pre-payment charges.

The question in the appeal is whether the part of the second bank loan comprising the sum of HK$467,600, namely the amount under the Organization C loan, falls within the definition of ‘home loan’ under section 26E(9) of the IRO.

Held:

1. The second bank loan was in substance taken out for the purpose of replacing the Organization C loan of a similar amount. It is only because of the rather unusual circumstances that the second bank loan could not be taken out earlier, and the

couple had to provide what is in effect a bridging finance for the short period between July and September 2004.

2. The factual situation falls within the spirit and intent of the legislation. What is required under section 26E is that the loan in question must be applied as a matter of fact and substance for the acquisition of the dwelling. The question which has to be answered is a hard practical matter of fact. Applying the test, the part of the loan which is in issue was applied for the acquisition of the dwelling.

3. The view taken by the Board in D123/01 that when a person substitutes an original mortgage of his home by a subsequent mortgage, the Commissioner may not be obliged under the definition of 'home loan' to continue granting that person the benefit of the 'home loan interest' deduction is too narrow.

Appeal allowed.

Cases referred to:

D2/01, IRBRD, vol 16, 121
D123/01, IRBRD, vol 16, 915

Taxpayer in person.
Leung To Shan and Chan Man On for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This appeal concerns the question of whether certain interest paid by the taxpayer can be regarded as 'home loan interest' within the meaning of section 26E of the Inland Revenue Ordinance ('IRO'). The Commissioner accepted that for the relevant year of assessment, namely 2005-2006, the taxpayer was entitled to a deduction of $8,706 for home loan interest. The taxpayer claimed, however, a deduction of $17,195 for the same year of assessment. That difference arises because the taxpayer claimed, but the Commissioner disagreed, that a sum of HK$467,600 out of a loan of $1,122,336 taken out by the taxpayer and her husband from Bank A on 15 September 2004 should be considered as a 'home loan' within the meaning of section 26E(9) of the IRO. How the issue arises in this appeal can only be properly understood when the more detailed facts are recited, but briefly, the question which arises in this appeal is whether, as a matter of law and as a matter of facts as found by the Board, the part of the loan in the sum of

HK$467,600 falls within the definition of 'home loan' under section 26E(9). In particular, the question is whether that part of the loan was applied for the acquisition of the property which the taxpayer and her husband resided in during the relevant year of assessment.

2. Section 26E(9) provides that 'home loan', in relation to a person claiming a deduction under that subsection 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

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

The facts

3. The facts are not in dispute and we find the following proved.

4. On or about 15 July 1999, the taxpayer and her husband purchased a property in their joint names in Address B from Organization C at the cost of HK$2,338,000. The purchase was financed by two mortgages; a first mortgage with Bank A in the sum of HK$950,000 (hereinafter referred to as 'the first Bank A loan'), and a second mortgage made available by Organization C in the sum of HK$467,600.

5. On 14 July 2004, the taxpayer and her husband repaid the Organization C loan of $467,600. They had in the meantime made an application to Organization C for an assessment of premium to release them from a restriction against alienation. The couple was informed of the figure assessed on 20 July 2004. The premium assessed was HK$641,000.

6. On 15 September 2004, the couple obtained a fresh loan from Bank A in the sum of $1,122,336.27 ('the second Bank A loan'). At the time, the amount outstanding on the first Bank A loan was $488,939.81. Part of the second Bank A loan was used to repay the first Bank A loan. There is no dispute that this part of the loan falls within the definition of 'home loan' under section 26E(9), so that interest on this part of the loan can be deducted under section 26E(1).

7. The completion statement of the handling solicitors shows the following:

Mortgage loan from Bank A		$1,122,336.27
Less		
Redemption amount payable to Bank A (calculated up to 15/9/04)	$488,939.81	

Premium payable to Government	$641,000	
Legal fees and disbursements	$3,400	
Amount due to Solicitors		$11,003.54

8. There is no dispute that the taxpayer and her husband resided in the Address B flat during the relevant year of assessment.

The evidence

9. The taxpayer and her husband gave evidence before the Board. The taxpayer explained that the repayment (in the sum of $467,600) they made on 14 July 2004 was out of sheer expediency; and that they had all along intended to take out the second loan from Bank A to replace the Organization C loan once circumstances permit.

10. Their action was dictated by a number of factors. First, the Organization C loan was interest-free for the first five years. However, in order to obtain a waiver of a 5% charge, the couple must repay that loan on 14 July 2004. They did not take out the second Bank A loan earlier than they did partly because an earlier repayment to Bank A would be subject to pre-payment charges, and also because the premium had not been assessed until 20 July 2004.

11. We accept the taxpayer's evidence as to the reason why the repayment and loans happened at the time they did. The taxpayer's husband also gave evidence that he made a telephone inquiry with the Inland Revenue Department as to whether interest on the loan on payment of premium can be deducted and was told that it could be. Since the taxpayer is unable to identify the officer involved, the Commissioner has not been able to call any rebuttal evidence. For reasons we shall give, we do not find it necessary to make a finding on this factual assertion.

Discussion

12. The question which this appeal raises is whether the taxpayer must show that the loan obtained was used directly to acquire the dwelling. If it has to be, the taxpayer would fail. It appears from the completion statement that the sum of $641,000 was used to pay the premium, and, as the Board held in D2/01, IRBRD, vol 16, 121, the use of a loan to pay for the purpose of removing a restriction on alienation cannot be said to be applying the loan for the acquisition of a dwelling.

13. We find, however, on the evidence that the loan in question was in substance taken out for the purpose of replacing the Organization C loan of a similar amount, and that it is only because of the rather unusual circumstances outlined in paragraphs 9 and 10 above that the second Bank A loan could not be taken out earlier, and the couple had to provide what is in effect a bridging finance for the short period between July and September 2004.

14. In the circumstances, the present case is in our view no different from a case where a

person has to use his own money to complete a transaction for the purchase of his dwelling because of practical difficulties in arranging for a mortgage loan from a bank in time for the completion, and is then able, within a short time, to arrange for the mortgage to finance the purchase. We take the view that both in this example and in the case at hand, the factual situation does fall within the spirit and intent of the legislation. In our view, what is required under section 26E is that the loan in question must be applied as a matter of fact and substance for the acquisition of the dwelling.

15. Take another example. A person purchases a dwelling with a mortgage financed by bank X. Two years later, he wishes to redeem the loan from bank X by obtaining a loan from bank Y, perhaps on less onerous terms. If one applies a strict construction to section 26E, it can be argued that the loan from bank Y does not qualify as a home loan. That appears to be the view taken by the Board in D123/01, IRBRD, vol 16, 915. In that appeal, the Board stated (in paragraph 24):

> *'Strictly speaking, when a person substitutes an original mortgage of his home by a subsequent mortgage, the Commissioner may not be obliged under the definition of "home loan" to continue granting that person the benefit of the "home loan interest" deduction. Nevertheless, as a matter of policy and practice, he still grants it as a concession.'*

16. We would also venture to doubt whether the Commissioner should be taken as making a concession when applying the practice referred to. The Commissioner of Inland Revenue is under a public law duty to administer the law in accordance with the IRO. She has no power to make concessions unless the IRO confers such power. None exists under section 26E. In our view, the practice of the Commissioner is sensible, and is entirely justified by a proper construction of the section.

17. With respect, the view taken by the Board in Case No 123 of 2001 appears to us to be too narrow. A statutory provision should be construed with the presumption that absurd results are not intended (*Bennion on Statutory Interpretation*, 5th ed., p. 969), and in this context, 'absurd' means contrary to sense and reason. Bennion says that the presumption leads to avoidance by the interpreter of six types of undesirable consequences: an unworkable or impractical result, an inconvenient result, and anomalous or illogical result, a futile or pointless result, an artificial result, and a disproportionate counter-mischief. The narrow view of the section adopted by the Board in Case No 123 of 2001 would certainly lead to inconvenient and anomalous results, which one should presume is unintended by the legislature.

18. We would suggest that section 26E requires the Commissioner to determine in every case whether as a matter of fact and substance the loan was applied to acquire the dwelling. This means that the factual inquiry should extend beyond the mere confines of something like a completion statement. Instead, the question has to be answered is a hard practical matter of fact. Applying that test, we find that the part of the loan which is in issue was applied for the acquisition

of the dwelling.

Conclusion

19. For these reasons, we would allow the appeal and remit the assessment to the Commissioner with our opinion thereon.