

Case No. D5/06

Salaries tax – cash allowance or refund of rent – Inland Revenue Ordinance ('IRO') sections 9(1)(a) and 9(1A)(a).

Panel: Colin Cohen (chairman), Malcolm Merry and Wong Fung Yi.

Date of hearing: 9 February 2006.

Date of decision: 10 April 2006.

The issue is whether the sum of \$90,000 per month received by the taxpayer from his employer, Company A, is a cash allowance or a refund of rent.

In December 1995, the taxpayer purchased a property through Company E which was beneficially owned by himself and his wife. He entered into a tenancy agreement with Company E. Company E obtained a mortgage from Company F for the purchase.

Arrangements were made by Company A to make monthly payments to Company F in the sum of \$47,738.6 as repayment of the loan that Company E had received for the purchase of the property. As to how the balance of \$90,000 was paid, the taxpayer's answer was vague. On cross-examination, the taxpayer admitted that the market rent of the property was not \$90,000 but peaked at about \$60,000 and then fell back to around \$40,000.

Held:

1. The Board was not satisfied that the payments from Company A were refunds of rent. Company A never made any refund of rent directly to Company E. Company A made a payment to Company F in the sum of \$47,738.6 and there is no evidence how any other payments were made to Company E by Company A.
2. It is undisputed that the taxpayer did not pay the rent to Company E and there was no refund of rent by Company A to the taxpayer. The sum received by the taxpayer was a cash allowance and not a refund of rent and thus being subject to salaries tax.
3. There was no genuine landlord and tenant relationship between Company E and the taxpayer. The letting of the property was an artificial transaction and should be disregarded.

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4. Having considered the ratable value of the property, the Board found the monthly rent of \$90,000 per month was double the market rent. The purported tenancy had no commercial reality or sense about it.
5. The assessments were correct and not excessive.

Appeal dismissed.

Cases referred to:

D8/82, IRBRD, vol 2, 8
D33/97, IRBRD, vol 12, 228
CIR v Peter Leslie Page 5 HKTC 683
D93/01, IRBRD, vol 16, 784

Taxpayer in person.

Poon So Chi for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal against additional salaries tax assessments raised on the Taxpayer for the years of assessment 1995/96 to 1999/2000.
2. During the course of the hearing, the Taxpayer was able to confirm to us that the facts upon which the determination was arrived at were agreed. We find these as facts and for ease of reference, we attach them as a Schedule to this decision.

The issue to be decided

3. The issue which we need to decide is whether the sum of \$90,000 per month received by the Taxpayer from Company A for the period 1 January 1996 to 31 March 2000 is a cash allowance chargeable to tax pursuant to section 9(1)(a) of the Inland Revenue Ordinance ('IRO') or a refund of rent within the meaning of section 9(1A)(a) of the IRO.

The Taxpayer's evidence

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4. The Taxpayer was in person and elected to give evidence. The Taxpayer has been in Hong Kong for 23 years and had worked for various employers. In April 1994, he was still employed by Company B and had lived at a property in Address C for approximately eight years. Since he had arrived in Hong Kong, he had always been provided with quarters and accommodation by his employers. He drew to our attention the fact that when he resided at Address C, his employer paid the rent directly to the landlord. He advised us that when he joined Company A, he indicated that there was a clear understanding that Company A would take over responsibility for providing accommodation, he also drew to our attention that his employment contract was focused on a profit sharing arrangement but his basic needs such as travel, accommodation and insurance would be taken care of.

5. In December 1995, he decided to purchase property at Address D. This was done through Company E. He confirmed that Company E was beneficially owned by himself and his wife. He asserted that it was agreed that Company A was always willing and prepared to pay \$90,000 a month by way of a housing allowance.

6. The Address D property was purchased on 15 December 1995 and in turn Company E obtained a mortgage from Company F. Arrangements were made by his employer, Company A to make monthly payments to Company F in the sum of \$47,738.6 as being repayment of the loan that Company E had received for the purchase of the Address D property. We asked as to how the balance of \$90,000 was paid, his answer was vague. He confirmed that there was some reimbursement of expenses. He also stated that he did not believe there was any money paid by his employer to Company E.

7. During the course of his evidence, he drew to our attention the circumstances that led to a tenancy agreement being entered into between Company E and himself. The Tenancy Agreement was unstamped and did contain the usual terms and conditions one would expect. He was of the view that there was never really any need for such terms to be included since if there was a dispute, he would be in a position to mediate between himself and Company E.

8. On cross-examination, the Taxpayer admitted that during the period in question the market rent of the Address D property was not \$90,000 but peaked at approximately \$60,000 and then fell back to around \$40,000.

9. The Taxpayer also stated that the reason for entering the tenancy agreement was that Company A required this for their audit requirements.

10. The Taxpayer's attention was drawn to various rental receipts that were issued. On the rental receipts, his signature appeared, however, he could not be sure as to when and how the rent was actually paid by him and thought this might have been done on an annual basis and in turn this was sorted out by his accountant.

The relevant statutory provisions

11. Section 8(1) of the IRO is the basic charging section for salaries tax and provides that salaries tax shall be charged on income from employment.

12. Income from employment is defined under section 9(1) of the IRO. The definition is non-exhaustive and states as follows:

'Income from any office or employment includes:

(a) any wages, salaries, leave pay, fee, commission, bonus, gratuity, perquisite or allowance, whether derived from the employer or others, ...

(b) the rental value of any place of residence provided rent-free by the employer or an associated corporation;'

13. A place of residence shall be deemed to be provided rent-free by the employer if the employer paid or refunded all the rent therefore and such payment or refund shall be deemed not to be income. Section 9(1A) stipulates the following:

'(a) Notwithstanding subsection (1)(a), where an employer or an associated corporation-

(i) Pays all or part of the rent payable by the employee; or

(ii) Refunds all or part of the rent paid by the employee,

such payment or refund shall be deemed not to be income;

(b) a place of residence in respect of which an employer or associated corporation has paid or refunded all the rent therefore shall be deemed for the purposes of subsection (1) to be provided rent free by the employer or associated corporation;'

14. Section 9(2) provides that the rental value of any place of residence shall be deemed to be 10% of the income as described in section 9(1)(a) of the IRO after deducting certain outgoings and expenses.

15. Section 61 empowers an assessor to disregard an artificial or fictitious transaction. The section provides as follows:

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‘Where an assessor is of opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the person concerned shall be assessable accordingly.’

Our decision

16. We remind ourselves that section 68(4) places on the Taxpayer the burden of proving that the assessment appealed against is excessive or incorrect.

17. We also need to have regard to section 51(1) of the Stamp Duty Ordinance (‘SDO’) which provides as follows:

‘... no instrument chargeable with stamp duty shall be received in evidence in any proceedings whatsoever except-

(a) criminal proceedings;

(b) civil proceedings by the Collector to recover stamp duty or any penalty payable under this Ordinance,

or be available for any other purpose whatsoever, unless such instrument is duly stamped.’

18. Hence, it is clear that an unstamped tenancy agreement is not admissible as evidence before a court or a tribunal.

19. Our attention was drawn to the following authorities:

(a) D8/82, IRBRD, vol 2, 8;

(b) D33/97, IRBRD, vol 12, 228;

(c) CIR v Peter Leslie Page 5 HKTC 683; and

(d) D93/01, IRBRD, vol 16, 784.

20. Having considered carefully and having reviewed all the evidence before us, in our view the Taxpayer has not been able to satisfy us or to show that the payments from Company A were refunds of rent. Company A never made any refund or reimbursement of rent directly to Company E. There was no evidence before us to show that the rent refund of \$90,000 per month was ever paid by Company A to Company E. What we had before us was evidence that Company A made a payment to Company F in the sum of \$47,738.6 and that no cogent or any other evidence was put before us to show as to how any other payments were made to Company E by

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Company A. We accept that the Taxpayer was entitled to a housing allowance as part of his emoluments. However, housing allowances are taxable unless they fall within the exception of section 9(1A). It is apparent from the undisputed evidence that the Taxpayer's allowance did not pay the rent to Company E and there was no refund of rent by Company A to the Taxpayer.

21. We also accept the Revenue's submissions that the sum received by the Taxpayer from Company A was undoubtedly a cash allowance and not a refund of rent. Therefore, the sum should be subject to salaries tax under the relevant provisions of sections 8 and 9(1)(a) of the IRO.

22. We have no difficulties in concluding that there was no genuine landlord and tenant relationship between Company E and the Taxpayer. As we have previously found the Taxpayer had not paid any rent to Company E for the relevant years in question.

23. We also conclude that the letting of the Address D property to Company E was an artificial transaction within the meaning of section 61 of the IRO and should be disregarded. At all relevant times, the Taxpayer and his wife were the only directors and shareholders of Company E. Company E did not carry out any business other than holding the property. The Taxpayer and his wife were the beneficial owners of the property and were entitled to use it as their residence if they so wished. We accept that no cogent nor any satisfactory explanation was given to us as to why it was necessary for the Taxpayer to rent his own property from Company E and that our conclusion was that the arrangement entered into was designed for tax purposes only.

24. The rateable value of the Address D property for the relevant years of assessment ranged from \$444,000 to \$558,000. Therefore, based on the rateable value of the property, the monthly market rent should have ranged from \$37,000 to \$46,500 per month for the relevant years of assessment. Therefore, the monthly rent of HK\$90,000.00 was double the market rent. We have no difficulties in coming to the conclusion that the purported tenancy was not negotiated at arm's length and had no commercial reality or sense about it.

25. During the course of the hearing, our attention was drawn to the journal listing of Company E which dealt with purported rental income of the Address D property. We have no hesitation in coming to the conclusion that the various entries in the journal listing were self-serving in an attempt to match the journal listing against the 'Amount due to a director' being the lump sum payment of \$1,080,000. Again, we also come to the conclusion that there was no purpose for the alleged letting of the Address D property by Company E to the Taxpayer other than to obtain a tax benefit.

26. The Taxpayer did draw to our attention that he accepted that he had not responded to the IRD's request for further information nor was he in a position to provide them with the relevant information they required. He also confirmed that his bookkeeping was somewhat tardy and haphazard. However, he also put to us that he accepted that rental was excessive but felt that there should be an adjustment to reflect a true market rent of the property in which he resided. Again, this

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supports our conclusion that the transaction was indeed artificial.

27. After having considered carefully the evidence, the facts and the law, it is quite clear that the appeal must be dismissed and that the assessments are indeed correct and are not excessive.

Determination

1. Facts upon which the determination was arrived at

- (1) Mr G ['the Taxpayer'] has objected to the 1995/96 to 1999/2000 additional salaries tax assessments raised on him. The Taxpayer claims that the assessments were excessive.
- (2)
 - (a) Company E is a private company incorporated in Hong Kong on 24 August 1993. At all relevant times, the Taxpayer and his wife, Mrs G, were the only directors and shareholders of Company E.
 - (b) On 15 December 1995, Company E acquired the property at Address D ['Property H'] and Address I at a consideration of \$7,500,000. Company E has since remained the owner of Property H and the share of the lots.
- (3) By a Letter of Appointment dated 1 March 1996 ('the 1996 Letter'), Company A set forth, inter alia, the following terms of the Taxpayer's appointment with Company A:
 - (a) '2. [Company J]

Within the '[Company A]' Group's organizational structure [Company J] is a separate planning and business unit. Other planning and business units of the '[Company A]' Group do, however, also conduct business in the name of [Company A's] Hong Kong branch.

...'
 - (b) '3. Function and Title

The [Company J] is managed by a team of top managers. You are Managing Director and member of the top management team. You are directly responsible for the overall management of the operation in Hong Kong.'
 - (c) '5. Commencement

Commencement date of your appointment is October 1, 1994.'

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(d) '6. Compensation Package

The compensation package will consist of the following three components:

- Basic Compensation Package
- Annual Performance Bonus Scheme
- Profit participation scheme

6.1 Basic Compensation Package

The Basic Compensation Package consists of the following:

- Base Salary: Your base salary is all inclusive and is fixed to be HK\$26'000 per month for the period 01.10.1994 until 31.12.1995 and may thereafter be reviewed annually.
- Housing Allowance: You will be entitled to a housing allowance equal to HK\$800'000 annually.

...'

The Taxpayer signed the 1996 Letter on 12 March 1996

(4) By a letter dated 2 January 1998 ('the 1998 Letter'), Company A set forth the terms within the Taxpayer's Basic Compensation Package that had been revised for the year of 1998 and confirmed the rest of the compensation package should be the same as that of year 1997. Clause 2 of the 1998 Letter stated that the Taxpayer's housing allowance had been revised to \$1,210,000 annually. The Taxpayer signed the 1998 Letter on 4 February 1998.

(5) On divers dates, Company A filed employer's returns for the years ended 31 March 1996 to 31 March 2000 in respect of the Taxpayer showing the following particulars:

Year ended 31 March	:	1996	1997	1998	1999	2000
(a) Capacity in which employed	:	Managing Director	Managing Director	Managing Director	Managing Director	Managing Director
(b) Period of employment	:	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
(c) Salary	:	\$1,433,000	\$709,500	\$1,035,624	\$1,381,754	\$939,795
Bonus	:	--	<u>774,000</u>	--	--	<u>1,441,196</u>
Total	:	<u>\$1,443,000</u>	<u>\$1,483,500</u>	<u>\$1,035,624</u>	<u>\$1,381,754</u>	<u>\$2,380,991</u>

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(d) (i) Quarters provided -					
Address	: Property K	Property H	Property H	Property H	Property H
	[Note]				
Period provided	: 1-4-1995 –	1-4-1996 –	1-4-1997 –	1-4-1998 –	1-4-1999 –
	31-12-1995	31-3-1997	31-3-1998	31-3-1999	31-3-2000
Rent paid to landlord	: 'X'	'X'		\$1,080,000	
by employer					
Rent paid to landlord			\$1,080,000		\$1,080,000
by employee					
Rent refunded to			\$1,080,000		\$1,080,000
employee					
(ii) Quarters provided -		--	--	--	--
Address	: Property H				
Period provided	: 1-1-1996 –				
	31-3-1996				
Rent paid to landlord	: 'X'				
by employer					
(e) Date of employer's return	: 17-5-1996	6-5-1997	30-4-1998	30-4-1999	26-6-2000

Note: Property K means Address C.

- (6) In his tax returns for the years of assessment 1995/96 to 1999/2000, the Taxpayer declared the income from Company A and quarters provided to him by Company A as follows:

Year ended 31 March	: 1996	1997	1998	1999	2000
(a) Income from Company A	: \$1,443,000	\$1,483,500	\$1,035,624	\$1,243,579	\$2,380,991
(b) (i) Quarters provided -					
Address	: Property K	Property H	Property H	Property H	Property H
Period provided	: 1-4-1995 –	1-4-1996 –	1-4-1997 –	1-4-1998 –	1-4-1999 –
	31-12-1995	31-3-1997	30-6-1998	31-3-1999	31-3-2000
Rent paid to landlord	: \$792,000 ^(A)	\$960,000	\$1,080,000	\$1,080,000	
by employer					
Rent paid to landlord					\$1,080,000
by the Taxpayer					
Rent refunded to the					\$1,080,000
Taxpayer by					
employer					
(ii) Quarters provided -		--	--	--	--
Address	: Property H				
Period provided	: 1-1-1996 –				
	31-3-1996				
Rent paid to landlord	: \$270,000 ^(B)				
by employer					
	(A) + (B)				
	= \$1,062,000				

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- (7) The Assessor, on divers dates, raised on the Taxpayer the following 1995/96 to 1999/2000 salaries tax assessments:

	1995/96	1996/97	1997/98	1998/99	1999/2000
	\$	\$	\$	\$	\$
Income per Fact (5)(c)	1,443,000	1,483,500	1,035,624	1,381,754	2,380,991
Rental value					
[Income per Fact (6)(a) x 10%]	<u>144,300</u>	<u>148,350</u>	<u>103,562</u>	<u>124,357</u>	<u>238,099</u>
	1,587,300	1,631,850	1,139,186	1,506,111	2,619,090
<u>Less:</u> Married person's allowance	--	--	(200,000)	(216,000)	(216,000)
Child allowance	<u>--</u>	<u>--</u>	<u>(54,000)</u>	<u>(60,000)</u>	<u>(60,000)</u>
Net chargeable income	<u>1,587,300</u>	<u>1,631,850</u>	<u>885,186</u>	<u>1,230,111</u>	<u>2,343,090</u>
Tax payable thereon	<u>238,095⁽¹⁾</u>	<u>244,777⁽¹⁾</u>	<u>166,237⁽²⁾</u>	<u>198,618</u>	<u>387,825</u>
Date of issue of assessment	4-11-1996	22-7-1997	28-7-1998	23-8-1999	23-8-2000

Note: (1) Tax charged at standard rate.

(2) Pursuant to the Tax Exemption (1997 Tax Year) Order, the tax payable for the year 1997/98 was subsequently reduced by 10% to \$149,613.

- (8) In response to the Assessor's enquiries regarding the Taxpayer's salaries tax liabilities for the year 1999/2000, Company A claimed in its letter dated 27 July 2001 that:

- (a) '[Company A] reimburses accommodation rental up to the lower of the amount specified in [the 1998 Letter] or the amount [the Taxpayer] has actually incurred on accommodation rental. Whatever the expenditure it must be evidenced by receipts and stamped lease.'
- (b) 'As indicated in [Fact (8)(a)] above [Company A] required [the Taxpayer] to provide the original rental receipts and a copy of the stamped tenancy agreement as evidence of the actual rental paid.'

- (9) In support of its claims in Fact (8), Company A provided the Assessor with copies of the following documents:

- (a) A tenancy agreement dated 1 January 1996 between Company E as the landlord and the Taxpayer as the tenant ('the Tenancy Agreement'). The Taxpayer signed the Tenancy Agreement both as the landlord on behalf of Company E and as the tenant whereby Property H was purportedly leased to the Taxpayer for a period of four years from 1 January 1996 to 31 December 1999 at a monthly rent of \$90,000. The Tenancy Agreement was unstamped.

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- (b) An extension of tenancy agreement dated 31 December 1999 between Company E as the landlord and the Taxpayer as the tenant ('the Extension Agreement'). The Taxpayer signed the Extension Agreement both as the landlord on behalf of Company E and as the tenant whereby the Tenancy Agreement was purportedly extended to 31 March 2000. The Extension Agreement was also unstamped.
- (10) By a letter dated 31 August 2001, in response to the Assessor's request for a copy of stamped tenancy agreement, Company A amended its claim in fact (8) in the following terms:
- '[The Tenancy Agreement] is not stamped. Under the terms of employment, stamping of the rental agreement was not required. We have relied on the contract terms of the lease to properly support the claim for rental reimbursement.'
- (11) Company A further provided the Assessor with 12 purported rental receipts for the 12 months from April 1999 to March 2000, allegedly issued by the Taxpayer on behalf of Company E on the 1st of the month, each showing that Company E received from the Taxpayer a sum of \$90,000, being payment of rental fee for the month. These rental receipts did not mention which property the rental fees were paid for or how the payments were made.
- (12) In response to the Assessor's enquiries regarding his salaries tax liabilities for the year 1999/2000, the Taxpayer claimed in his letter dated 11 September 2001 that:
- (a) 'I run a current account covering various regular expenses including rent with [Company E]. My employer reimburses me monthly for the rental'.
- (b) 'The purchase [of Property H] was funded by a personal loan made by myself to [Company E] together with a mortgage taken out by [Company E].'
- (13) By a letter dated 20 September 2001, the Assessor requested the Taxpayer to provide further information and documents regarding his salaries tax liabilities for the years 1995/96 to 1999/2000. The Taxpayer failed to furnish the required information and documents.
- (14) On 19 February 2002, the Assessor raised on the Taxpayer the following 1995/96 to 1999/2000 additional salaries tax assessments to assess the purported rent in respect of Property H in full:

	1995/96	1996/97	1997/98	1998/99	1999/2000
	\$	\$	\$	\$	\$
Income per fact (5)(c)	1,443,000	1,483,500	1,035,624	1,381,754	2,380,991
Purported rent in respect of					

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Property H	<u>270,000</u>	<u>1,080,000</u>	<u>1,101,000</u>	<u>1,080,000</u>	<u>1,080,000</u>
	1,713,000	2,563,500	2,136,624	2,461,754	3,460,991
<u>Less:</u> Married person's allowance	--	--	--	(216,000)	--
Child allowance	<u>--</u>	<u>--</u>	<u>--</u>	<u>(60,000)</u>	<u>--</u>
Net chargeable income	1,713,000	2,563,500	2,136,624	2,185,754	3,460,991
<u>Less:</u> Net chargeable income previously assessed [fact (7)]	<u>(1,587,300)</u>	<u>(1,631,850)</u>	<u>(885,186)</u>	<u>(1,230,111)</u>	<u>(2,343,090)</u>
Additional net chargeable income	<u>125,700</u>	<u>931,650</u>	<u>1,251,438</u>	<u>955,643</u>	<u>1,117,901</u>
Tax payable thereon	<u>18,855⁽¹⁾</u>	<u>139,748⁽¹⁾</u>	<u>138,831^{(1)&(2)}</u>	<u>162,460</u>	<u>131,323⁽¹⁾</u>

Note: (1) Tax charged at standard rate.

(2) After 10% tax rebate.

- (15) Messrs L [‘the Representatives’] objected on behalf of the Taxpayer to the 1995/96 to 1999/2000 additional salaries tax assessments in Fact (14) on the grounds that the assessments were excessive. In amplification, the Representatives put forward the following arguments:

‘[The Taxpayer] is entitled to place of residence provided by the employer and such benefits should only be assessed based on the rental value which is 10% of the assessable income (i.e. his reported salaries) in accordance with Section 9(2) of the Inland Revenue Ordinance [‘the Ordinance’].’

- (16) In correspondence with the Assessor, the Representatives provided the following information:

- (a) ‘[The Taxpayer] was employed by [Company A] from 1994. [The Taxpayer] was previously employed by another insurance company, [Company B] in Hong Kong. [Group of Company A] employed [the Taxpayer] as managing director of [Company A], and [the Taxpayer] was responsible for establishing and expanding [the Group of Company A]’s business in Hong Kong. At that time the employer only had an insurance license and had yet to expand its business. [The Taxpayer] was offered with a remuneration package commensurate for top management including a place of residence to be provided.’
- (b) ‘For the period until 31 December 1995, [the Taxpayer] rented [Property K] as his place of residence. The rental for Property K was HK\$60,000 and increased to HK\$88,000 in August 1995. [Property K] was rented from an unrelated party.’

In this connection, the Representatives furnished a copy of a letter dated 17 July 1995 from Messrs M to Company A, in relation to the consent to Company A’s proposed tenancy of Property K for a term of two years commencing from 1 August 1995 at a monthly rent of \$88,000.

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- (c) '[The Taxpayer] was provided with a housing allowance specified in his employment letters [i.e. the 1996 Letter and the 1998 Letter]. He rented [Property K] from an unrelated party for the period until 31 December 1995. He changed his residence to [Property H] on 1 January 1996.'
 - (d) '[Company E] has reported the rental [of Property H] as taxable income for the respective years of assessment.'
- (17) The Representatives also claimed that:
- (a) '[The Tenancy Agreement for Property H] is not stamped as agreed between the landlord [i.e. Company E] and [the Taxpayer].'
 - (b) The reason why rental deposit was not stated in the Tenancy Agreement for Property H; 'The landlord [i.e. Company E] agreed that no deposit was required.'
 - (c) 'The monthly rental [of Property H since January 1996] was mutually agreed between [the Taxpayer] and the landlord [i.e. Company E]. Both parties have taken into consideration the rental level of similar properties, and the fact that the property was fully furnished and inclusive of all government rent and rate, utilities, building management fee, and expenses for repairs and maintenance.'
 - (d) 'The rent was partially paid by [Company A] and partially paid by [the Taxpayer]. The mortgage loan of [Property H] was obtained from [Company F]. [Company A] made monthly payments direct to [Company F] for settlement of the mortgage loan of the landlord [i.e. Company E]. The balance of the rent was reimbursed to [the Taxpayer].'
- In this connection, the Representatives furnished copies of two official receipts dated 26 and 29 March 2001 issued by Company F, each acknowledging receipt from [Company A] a sum of \$47,738.60 in settlement of the loan repayments for February and March 2001 respectively.
- (e) '[The Taxpayer] is the director of the landlord, [Company E] and holds a current account in [Company E]. The rent payable was set off against the current account with [the Taxpayer].'
 - (f) 'Both residences [at Property K and Property H] were provided by [Company A] by provision of a housing allowance as covered under [the 1996 Letter and the 1998 Letter].'

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(18) The Assessor wrote to the Taxpayer to explain that the purported rent refund in respect of Property H should be assessed in full as cash allowance. She invited the Taxpayer to withdraw the objection. The Representatives did not accept the Assessor's view and put forth the following further arguments:

- (a) '[The Taxpayer] and [Company E] ("the landlord") mutually agreed the terms and conditions for leasing [Property H]. Since both parties have agreed and accepted the terms and conditions mentioned in [the Tenancy Agreement, the Tenancy Agreement] is legally binding notwithstanding that it has not been stamped. The landlord may has (sic) overlooked the requirement of stamping [the Tenancy Agreement], but this does not affect the validity of [the Tenancy Agreement], especially as both parties regard the terms and conditions of [the Tenancy Agreement] as binding.'
- (b) '[The Taxpayer] does not consider that it is unusual for the landlord [i.e. Company E] to pay for the utilities, and believes this is now becoming far more common in Hong Kong. As mentioned in our previous letter the parties have taken into consideration the rental level of similar properties, the fact that the property is fully furnished and inclusive of all government rent and rates, building management fee, utilities, and expenses for repairs and maintenance.'

In this connection, the Representatives furnished copies of six electricity bills for Property H covering the period from 15 February 1999 to 15 February 2000.

- (c) 'The landlord [i.e. Company E] is a separate legal entity and is engaged in the business of property letting. The landlord is a limited company in Hong Kong and has complied with all statutory requirements in Hong Kong. It is up to the landlord to lease out its property and earn rental income. The rental income has been duly reported to your department and assessed to profits tax. The method of payment of rental can not be the predominant reason in taking the view that the arrangement was artificial.'
- (d) 'The employer, [Company A] paid directly to [Company F] (the mortgagee of [Property H]) to settle the landlord's mortgage loan, which demonstrates that [Company A] undertook to pay part of the rental directly to the landlord.'
- (e) 'Finally, we consider that it is more important to recognize the fact that [the Taxpayer] is entitled to the provision of quarters by [Company A] on the following grounds:
 - i) [The Taxpayer] was employed by [Company B] (ex-employer of [the Taxpayer]) under expatriate terms with the provision of quarters since his

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arrival in Hong Kong in 1982 through termination of employment in 1994.

- ii) [The Taxpayer] was contracted by Company N to be the Managing Director to establish insurance business in Hong Kong. At that time, [Company A] had no establishment in Hong Kong and [the Taxpayer's] contract was negotiated and concluded in Country O (please refer to [the 1996 Letter and the 1998 Letter] that the letters were issued and signed by [Company N]).

[The Taxpayer] requested a remuneration package comparable with that of Company B which included the provision of quarters. [Company A] had effectively taken over the lease of [Property K] from Company B ...

- iii) It is fairly standard for a multinational corporation to provide an expatriate with quarters, and [Company A] has provided all its senior expatriates with quarters. It does not make commercial sense that [the Taxpayer], being an expatriate from Europe and Managing Director of [Company A], would be appointed without the provision of quarters.
- iv) It was [the Taxpayer's] decision (with [Company A's] approval) to move from [Property K] to [Property H]. Although the owner of [Property H] is related to [the Taxpayer], this would not override the fact that [the Taxpayer] was entitled to quarters and the reimbursement of rental from [Company A] is therefore only taxable at 10% of the income under Section 9(2) of [the Ordinance].'

- (19) The Representatives also provided the Assessor with copies of the following documents:

- (a) Demand for Rates for Property H for the quarters ending 30 June 1996 and 31 March 1997 and Demand for Rates and/or Government Rent for Property H for quarters ending 30 June 1998, 31 March 1999, 30 June 2000 showing rateable value as follows:

<u>Year of assessment</u>	<u>Rateable value</u>
	\$
1996/97	474,000
1998/99	558,000
2000/01	312,000

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- (b) The journal listing of Company E for the year from 1 January to 31 December 1999. The journal dates of all the transactions in the journal listing were 31 December 1999. The purported rental income of Property H for the 12 months, the repayment of mortgage loan and mortgage loan interest for the year 1998 in lump sums of \$1,080,000, \$181,751.22 and \$435,585.55 respectively were all posted to the journal listing against the 'Amount due to director'.
- (c) The general ledgers of Company E for the year from 1 January to 31 December 1999.
- (d) The trial balance of Company E as at 31 December 1999.
- (e) Company E's accounts for the years ended 31 December 1995 to 1999.
- (f) A tenancy agreement dated 15 September 1993 entered into by Company B as the tenant by which Company B rented Property K for a term of two years commencing on 1 August 1993 at a monthly rent of \$60,000, inclusive of rates.
- (20) In Company E's accounts and tax computations for the years ended 31 December 1996 to 2000, the following income, expenses and losses were shown:

Year ended 31 December	1996	1997	1998	1999	2000
	\$	\$	\$	\$	\$
Rental income	1,080,000	1,080,000	1,080,000	1,080,000	590,000
Other operating income	<u> --</u>	<u> --</u>	<u> --</u>	<u> 1,820</u>	<u> --</u>
	<u>1,080,000</u>	<u>1,080,000</u>	<u>1,080,000</u>	<u>1,081,820</u>	<u>590,000</u>
<u>Less: Expenses</u>					
Interest paid [Note]	(407,322)	(402,576)	(517,343)	(435,586)	(366,871)
Other expenses	<u>(649,068)</u>	<u>(681,819)</u>	<u>(654,449)</u>	<u>(698,579)</u>	<u>(545,754)</u>
	<u>(1,056,390)</u>	<u>(1,084,395)</u>	<u>(1,171,792)</u>	<u>(1,134,165)</u>	<u>(912,625)</u>
Profits/(Loss) before taxation	<u> 23,610</u>	<u> (4,395)</u>	<u> (91,792)</u>	<u> (52,345)</u>	<u> (322,625)</u>
Assessable profits/(Adjusted loss) per tax computation	<u> 64,859</u>	<u> 57,652</u>	<u> (85,534)</u>	<u> (23,794)</u>	<u> (313,997)</u>

Note: Property pledged as security: Property H. The principal sum of mortgage loan obtained was \$6,375,000, which was repayable by 120 monthly instalments of \$71,785 each and amended in 1997 to 240 monthly instalments of \$46,834.79 each

- (21) The Assessor has ascertained the rateable value of Property H as follows:

<u>Year of assessment</u>	<u>Rateable value</u>
	\$
1995/96 and 1996/97	474,000
1997/98 and 1998/99	558,000

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1999/2000	444,000
2000/01 and 2001/02	312,000

- (22) By a letter dated 22 April 2005, the Assessor invited the Representatives to comment on Facts (1) to (22). The Assessor also requested the Representative to furnish further information and documents, in particular, copies of rental receipts for Property H for the periods from 1 January 1996 to 31 March 1999.
- (23) By a letter dated 25 September 2005, the Taxpayer himself responded to the Assessor's letter. However, the Taxpayer did not provide the documents requested by the Assessor but claimed, inter alia, that:
- (a) 'I wish to state that, whilst I would admit to poor record keeping and some incorrect procedures, the fundamental principle is that I was genuinely granted an entitlement to housing quarters by my employer.'
 - (b) 'When I started full time employment with [Company A], I was in the same residence and the company agreed to provide me with the same quarters. Again this is exactly what one would expect.
- Subsequently, [Company A] agreed to provide me with quarters in a different property which was of a similar standard and at a similar rent. This new property [i.e. Property H] happened to be owned by [Company E], a company which I own, but this latter fact does not affect the genuineness or validity of the arrangement. A separate company [in the Group] also agreed to provide [Company E] with a mortgage facility. It was surely natural that I should use any new connections to obtain best terms for this private arrangement but again I do not see that this is relevant to my entitlement within my quite separate employment position.'
- (24) In response to the Assessor's further enquiries, Company A provided the Assessor with copies of, inter alia, the following documents:
- (a) A Letter of Understanding entered into between the Taxpayer and Company A on 21 December 1994 ('the LOU'). Clause 4 of the LOU, which contained details of the Taxpayer's compensation package, did not mention any housing allowance or housing benefit to the Taxpayer.
 - (b) A letter dated 1 March 1996 from Company A to the Taxpayer ('the 1996 Second Letter') in which Company A set forth the terms within the Taxpayer's Basic Compensation Package that had been revised for the year of 1996 and confirmed the rest of the compensation package should be the same as that of

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year 1995. Clause 2 of the 1996 Second Letter stated that the Taxpayer's housing allowance had been revised to \$960,000 annually. The Taxpayer signed the 1996 Second Letter on 12 March 1996.

- (25) The Assessor maintains the view that the purported rent in respect of Property H should be assessed in full on the Taxpayer. However, she considers that the 1995/96 and 1997/98 additional salaries tax assessments should be revised as follows:

	1995/96	1997/98
	\$	\$
Income per fact (5)(c)	1,443,000	1,035,624
Rental value in respect of Property K [\$1,443,000 x 9/12 x 10%]	108,225	--
Purported rent in respect of Property H	<u>270,000</u>	<u>1,080,000</u>
Net chargeable income	1,821,225	2,115,624
<u>Less: Net chargeable income</u> previously assessed [fact (7)]	<u>1,587,300</u>	<u>855,186</u>
Additional net chargeable income	<u>233,925</u>	<u>1,230,438</u>
Tax payable thereon	<u>35,088</u> ⁽¹⁾	<u>135,996</u> ^{(1)&(2)}

Note: (1) Tax charged at standard rate.

(2) After 10% tax rebate.