INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D53/04

Salaries tax – whether the sums are cash allowance chargeable to tax – whether the sums are refunds of rent – sections 9(1)(a), 9(1A)(a) and 68(4) of the Inland Revenue Ordinance ('IRO') – the contractual agreement would shed light on whether the sum in question was consideration paid for use of a property.

Panel: Ronny Wong Fook Hum SC (chairman), Vincent Kwan Po Chuen and Vernon F Moore.

Date of hearing: 3 July 2004.
Date of decision: 26 October 2004.

The appellant was employed as a managing director in Company B. The quarter provided by company B was the subject premises purchased by Company E. The appellant was one of the two directors and shareholders of Company E.

The appellant and Company E provided various documents trying to show that the appellant's relationship with Company E is one of landlord and tenant. The issue is whether the sums paid by Company B to the appellant for the years of assessment are cash allowances chargeable to tax in terms of section 9(1)(a) of the IRO or whether they are refunds of rent within the meaning of section 9(1A)(a) of the IRO.

Held:

1. The Board is of the view that the contractual agreement would shed light on whether the sum in question was consideration paid for use of a property (D33/97, IRBRD, vol 12,228; Commissioner of Inland Revenue v Peter Leslie Page, IRBRD, vol 17, 854; D35/03, IRBRD, vol 18, 485 considered).

2. By virtue of section 68(4) of the IRO, the onus of proof rests on the appellant. The Board considered that the appellant made contradictory statements to the Revenue in the course of the Revenue's investigation. The Board is not prepared to accept the submission of the Memoranda of Lease by the appellant as genuine contemporaneous documents. The history of their revelation bears all the hallmarks of these being self-serving documents produced to advance the appellant's case.

3. The Board further does not accept the bare assertions of the appellant in his letter as to the circumstances leading to the execution of the Memoranda. The appellant did not see fit to attend the hearing before the Board. The bare assertions are untested by cross examination. The Board does not have any explanation from the appellant for his inconsistencies. The difficulty of the case is the absence of evidence to prove the underlying contractual arrangement. Conflicting assertions were made in pre-hearing correspondence passing between the parties. It behoves the appellant to give the Board some explanation on the inconsistencies and describe to the Board how the tenancy was in fact concluded (D33/97, IRBRD, vol 12, 228 followed).

Appeal dismissed.

Cases referred to:

D33/97, IRBRD, vol 12, 228
Commissioner of Inland Revenue v Peter Leslie Page, IRBRD, vol 17, 854
D35/03, IRBRD, vol 18, 485

Go Min Min for the Commissioner of Inland Revenue.
Taxpayer represented by his tax representative.

Decision:

Background leading to this appeal

1. By letter dated 10 February 1991, Company A offered to the Appellant the position of Managing Director in that company. Clause 3 of that letter provided that:

> *'Your basic salary will be $27,500.00 per quarter and [Company A] is agreed to provide quarter to you at the time when the Board of Directors approve ...'.*

2. By letter dated 1 April 1994, Company A informed the Appellant that his employment was transferred to Company B consequential upon the re-organization of the Group of Companies.

3. On 31 May 1999, 2000 and 2001, Company B filed employer's returns for the years ended 31 March 1999, 2000 and 2001 respectively in respect of the Appellant showing the following particulars:

Year of assessment	Capacity employed	Period of employment		Salary	Quarters provided				
		From	To		Period provided	Address	Nature	Rent paid to landlord by employee	Rent refunded to employee
1998/99	Managing Director	1-4-1998	31-3-1999	$307,152	1-4-1998 to 23-12-1998 24-12-1998 to 31-3-1999	Address C Address D ['the Subject Premises']	Apartment Apartment	$330,410 $150,000	[Blank]
1999/2000	Managing Director	1-4-1999	31-3-2000	$300,400	1-4-1999 to 31-3-2000	The Subject Premises	Apartment	$360,000	[Blank]
2000/01	Managing Director	1-4-2000	31-3-2001	$300,400	1-4-2000 to 31-3-2001	The Subject Premises	Apartment	$840,000	[Blank]

4. The Subject Premises was purchased by Company E on 10 February 1998 for $25,593,200. The Appellant and one XXXX are the only directors and shareholders of Company E. The Appellant hold 50% of the shares in Company E.

5. In response to the assessor's enquiries relating to the quarters provided for the year 1998/99, the Appellant furnished to the Revenue various documents including the following:

(a) A letter ['the Intimation Letter'] dated 2 November 1998 from Company B to the appellant in these terms:

'*In view of the termination of your tenancy agreement dated 24 December 1996, the Board of Director has approved to provide the following new quarter to you.*

1. New Address of quarter : [The Subject Premises]

2. Rental Charges : HK$50,000.00 per month inclusive of Management fee, government rent and rates.

3. Tenancy Period : Start from 1 January 1999 until further notice

(Without Tenancy Agreement) [Company B] has the right to give 2 months advance notice to

terminate the quarter.'

(b) A letter signed by Company E and the Appellant dated 23 December 1998 ['the Internal Memo'] which provided that

'[Company E] agreed to charge HK$50,000.00 per month to [the Appellant] for renting of above premises starting from 24 December 1998. [The Appellant] has the right to terminate the renting of [the Subject Premises] with 2 months advance notice'.

In response to enquiries from the Revenue dated 9 May 2001, Company E informed the Revenue on 18 May 2001 that the Internal Memo *'is <u>not</u> a tenancy agreement. It is just an internal memo for our record and it is not legal binding. In fact, no tenancy agreement was signed in the said period, and therefore no stamped tenancy agreement is available'.* The letter was signed by Mr F as its 'Finance & Admin. Manager'.

(c) A Memorandum of Lease said to have been made on 24 December 1998 between Company E and the Appellant whereby Company E let the Subject Premises to the Appellant for three months from 24 December 1998 to 31 March 1999 with rent at $50,000 per month payable *'in advance without any deduction on or before the 2nd day of each calendar rental period during the term provided'.* This Memorandum of Lease is not stamped. It was not submitted to the Revenue until 22 August 2003.

(d) Minutes of a meeting of the Board of Directors of Company B dated 24 December 1998 approving the said Memorandum of Lease and resolving that Company B shall reimburse the Appellant 'the monthly rent paid by him to the landlord according to the Memorandum [of Lease]'.

(e) A debit note dated 28 December 1998 from Company E to the Appellant for $150,000 being *'Rental Fee from 01/01/99 to 31/03/99 (Including all charges, i.e. Government Rent and Rates and Management Fee).'*

(f) An 'Official Receipt' dated 1 January 1999 from Company E to the Appellant for $150,000.

6. The documentation in respect of the Appellant's claim for the subsequent years follows a similar pattern as that applicable to the claim for the year 1998/99. The differences are:

(a) The applicable internal memo and memorandum of lease were dated the same date, namely, 1 April 1999 and 1 April 2000.

(b) Company E issued monthly receipts for rental fee paid 'by settlement of the amount due to [the Appellant] from the company'.

7. In correspondence exchanged between the Appellant and the Revenue prior to the hearing before us, the Appellant asserted:

(a) In letter dated 14 August 2001 that *'No tenancy agreement was signed with [Company E], the landlord, in respect of my residence covering the periods 1.4.1999 to 31.3.2000 and 1.4.2000 and 31.3.2001. Copies of the rental receipts for the same period are enclosed for your perusal'.*

(b) In letter dated 9 June 2003 that *'No tenancy agreements were signed between [Company E] and me because I own 50% shareholding of [Company E]. As such, [Company E] has no risk of not signing tenancy agreement with me for cases like I do not pay rental to [Company E] promptly etc, and there is no need to obtain such documents for any court case. Alternatively, I have signed an internal document for the lease with [Company E], and [Company E] issued official receipts to me monthly.'*

(c) In letter dated 22 August 2003 that *'[Mr F], the Finance Manager of [Company E], was responsible to negotiate the tenancy with me. He verbally offered me the monthly rent of [the Subject Premises] according to the fair market rent, and we would negotiate the terms of the tenancy. Upon mutual agreement on all terms of the tenancy, a Memorandum of Lease would be signed by the Director of [Company E] (as landlord) and I (as Tenant) and [Mr F] acted as witness for the Memorandum ... In fact, [the Internal Memo] (dated 23.12.1998) only represented the preliminary intention and negotiation of the tenancy between [Mr F] and I ... The final agreed monthly rent and other terms of the tenancy for the period from 01.01.1999 to 31.03.1999 should be referred to ... Memorandum of Lease dated 24.12.1998, which was signed by the Director of [Company E] and I'.*

8. In response to enquiries from the Revenue, Company E also stated in letter dated 14 August 2001 that *'No formal tenancy agreements were signed by [the Appellant] and [Company E]. Instead, copies of the internal records agreed by both parties covering the periods are enclosed for your reference'.*

9. The issue before us is whether the sums of $150,000, $360,000 and $840,000 paid by Company B to the Appellant for the years of assessment 1998/99, 1999/2000 and 2000/01 are

cash allowances chargeable to tax in terms of section 9(1)(a) of the Inland Revenue Ordinance ['IRO'] or whether they are refunds of rent within the meaning of section 9(1A)(a) of the IRO.

The applicable statutory provisions in the IRO

10. Section 9(1) provides that *'Income from any office or employment includes -*

(*a*) *any wages, salary ... perquisite, or allowance ...*

(b) the rental value of any place of residence provided rent-free by the employer ...'

11. Section 9(1A) provides that

' (a) Notwithstanding subsection (1)(a), where an employer ...

(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 ... has paid or refunded all the rent therefor shall be deemed for the purposes of subsection (1) to be provided rent free by the employer ...'

12. Section 68(4) that *'The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant'.*

The stamp Duty Ordinance (Chapter 117)

13. Section 15(1) of the Stamp Duty Ordinance provided that *'... no instrument chargeable with stamp duty shall be received in evidence in any proceedings whatsoever ...'*

The relevant authorities

14. In Case No D33/97, IRBRD, vol 12, 228, the taxpayer purported to enter into lease agreements with his parents concerning two properties. Property A was owned by his parents. 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. Returns were submitted by the respective owners of Property A and Property B disclosing the rental payments. The Board held

that the amounts in question cannot be classified as a refund of rent as *'no legal relationship of landlord and tenant was ever created between the Taxpayer and his parents'*. The Board relied on the fact that the lease agreements were unstamped as demonstrating that *'there was never any intent on the part of the Taxpayer and his parents to enter into legal relations'*.

15. In Commissioner of Inland Revenue v Peter Leslie Page, IRBRD, vol 17, 854, Recorder Edward Chan SC held that:

(a) Unless the taxpayer had made a payment as rent, there could be no question of his receiving any refund of rent from his employer.

(b) It is wrong to suggest that in order to make the payment by the employer as a refund of rent, the employer would have to exercise some control over the ways in which the amount paid to the taxpayer is to be spent.

(c) The intention of the parties is the real test. The relevant point of time is the time of the payment of the money by the employer.

16. In Case No D35/03, IRBRD, vol 18, 485, the Revenue argued that the word 'rent' refers to a periodical payment reserved as such in a lease and payable by the tenant to the landlord. The Board held that this submission of the Revenue *'placed too restrictive an interpretation of the concept of rent (when she insisted that a landlord and tenant relationship must exist between the Appellant and the owner of the Property). For instance, if the accommodation provided was a hostel or hotel room, and an employee paid for such accommodation,, no landlord and tenant relationship would exist. Usually in such a case the employee would occupy the accommodation under the terms of a licence. Yet clearly the intention of the IRO shows that such payments would qualify as "rent" for the purposes of section 9(1A) and the Commissioner in computing rental value would take into account any refund to the employee by the employer. And what would be the result if the tenant were not Company B but the Appellant's wife? Would the Commissioner take the same approach and deny that the Appellant had paid rent for the matrimonial home? Neither of these examples nor the present case seems abusive, and we doubt whether any purposive construction of the phrase "the rent paid by the employee" contained in section 9(1A)(a)(ii) would lead to denying a claim under that provision simply because there is no landlord and tenant relationship between the employee and the owner or lessor of the premises'*.

17. We are of the view that in Case No D35/03, the Board rejected the argument that the word 'rent' should be confined to a relationship of landlord and tenant. The Board took the view that the word covers payments made in the context of a licence. There is no suggestion in that case that the word extends to gratuitous payment made in the absence of any contractual agreement. The contractual agreement would shed light on whether the sum in question was consideration paid for use of a property.

Our decision

18. It is the Appellant's case that his relationship with Company E is one of landlord and tenant. By virtue of section 68(4) of the IRO, the onus of proof rests on the Appellant.

19. The Appellant made contradictory statements to the Revenue in the course of the Revenue's investigation. At all material times right up to 22 August 2003, his position was that no tenancy agreement was signed with Company E. The sudden emergence of the Memoranda of Lease on 22 August 2003 demonstrates the Appellant's awareness of the need to prove his requisite contractual nexus with Company E. Quite apart from the inadmissibility of these Memoranda by virtue of section 15(1) of the Stamp Duty Ordinance, we are not prepared to accept these as genuine contemporaneous documents. The history of their revelation bears all the hallmarks of these being self-serving documents produced to advance the Appellant's case.

20. It follows from our rejection of the Memoranda that we do not accept the bare assertions of the Appellant in his 22 August 2003 letter as to the circumstances leading to the execution of the Memoranda. The Appellant did not see fit to attend the hearing before us. The bare assertions are untested by cross examination. We do not have any explanation from the Appellant for his inconsistencies.

21. The Internal Memo carries no weight. Quite apart from the stamp duty point, that document only 'represented the preliminary intention and negotiation'. It therefore throws no light on the contractual relationship between the Appellant and Company E.

22. Mr Jammy Lui, tax representative of the Appellant, submitted that by virtue of section 6 of the Conveyancing and Property Ordinance a written tenancy agreement is not necessary for a term of less than three years. We agree. The difficulty of his case is the absence of evidence to prove the underlying contractual arrangement. Conflicting assertions were made in pre-hearing correspondence passing between the parties. It behoves the Appellant to give us some explanation on the inconsistencies and describe to us how the tenancy was in fact concluded. In the absence of such evidence in this case we find ourselves in agreement with the views expressed by this Board in Case No D33/97 at page 239

> *'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 ... upon the formal niceties of paying cheques to a family member, issuing receipts and completing property returns.'*

23. The Revenue also prayed in aid section 61 of the IRO. Given our views as stated above, it is unnecessary for us to make any ruling in relation to this alternative submission of the Revenue.

24. For these reasons, we dismiss the Appellant's appeal and confirm the assessments.