INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D69/04

Salaries tax – housing allowance – whether bona fide landlord and tenancy relationship.

Panel: Ronny Wong Fook Hum SC (chairman), Edward Chow Kam Wah and Ronald Tong Wui Tung.

Date of hearing: 10 July 2004.
Date of decision: 30 December 2004.

In September 1997, the appellant and her sister purchased a property as joint tenants. For the purchase, they borrowed two loans being $300,000 and $4,263,700 from a bank and the monthly installments required were $7,390 and $35,053 respectively.

In May 2001, the appellant was provided by her employer housing allowance of $25,000 per month. She claimed that she then rented the property and entered into a tenancy agreement with her sister at the monthly rent of $25,000. Nevertheless, all the rent she paid to her sister was returned to her for offsetting her sister's share of the installments which the appellant paid on behalf of her.

Held:

1. The appellant adduced no evidence on the state of account between her and her sister prior to the employment in question. It was unknown whether she was in occupation of the property and if so the nature of her occupation.

2. On the assumption of equal responsibility, the appellant's sister share for the monthly installments would be $21,221 ($7,390/2 + $35,053/2). The appellant could not explain why all the rent ($25,000) was returned to her.

3. The Board found that the appellant was merely trying to inflate the figures so as to match the sum of $25,000 being the housing allowance provided to her.

4. The Board did not accept that the appellant did pay rent to her sister pursuant to a bona fide tenancy agreement between them.

Appeal dismissed.

Cases referred to:

Commissioner of Inland Revenue v Peter Leslie Page, IRBRD, vol 17, 854
D33/97, IRBRD, vol 12, 228
D149/00, IRBRD, vol 16, 83

Chow Cheong Po for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. By an agreement for sale and purchase dated 29 August 1997, the Appellant and her sister Madam A purchased as joint tenants Property B for $5,561,000.

2. By letter dated 3 September 1997 from Bank C to the Appellant and Madam A, Bank C extended in favour of the Appellant and Madam A a loan of $300,000. This $300,000 loan was repayable by 48 monthly instalments of $7,390 each. The last of such instalment fell due in September 2001. The letter of 3 September 1997 and the repayment schedule in respect of this $300,000 loan were sent to Madam A's residential address. On the assumption that the Appellant and Madam A had to shoulder this loan on an equal basis, each had to pay $3,695 per month.

3. On 19 September 1997, Bank C extended a further loan of $4,263,700 in favour of the Appellant and Madam A. By an equitable mortgage dated 19 September 1997, Property B was mortgaged by the Appellant and Madam A in favour of Bank C. This $4,263,700 loan was repayable by 300 monthly instalments of $35,053.74 each. The statements in respect of this mortgage loan were sent to the Appellant at Property B address. On the like assumption that the Appellant and Madam A had to shoulder this loan on an equal basis, the proportionate liability of each was $17,526.87 per month.

4. The occupation permit in respect of Property B was issued on 22 December 1997. The Property B was assigned in favour of the Appellant and Madam A on 29 April 1998. It was charged in favour of Bank C on the same day.

5. Between 1 April 2001 and 4 April 2001, the Appellant was employed by Company D as its company secretary. Company D did not provide any place of residence to the Appellant.

6. Between 1 April 2001 and 23 April 2001, the Appellant worked as company secretary for Company E. Her salary for that period was $3,833 and Company E did not provide her with any place of residence during this period.

7. By letter dated 24 April 2001, Company E offered to employ the Appellant as company secretary as from 24 April 2001. Clause 1 of this offer letter provided as follows:

> ' Remuneration
>
> | | | | |
> |---|---|---|---|
> | (a) | Basic Salary | : | HK$20,000 per calendar month |
> | (b) | Housing Allowance | : | HK$25,000.00 per calendar month |
> | (c) | Guarantee Bonus | : | Two months' basic salary'. |

This offer was accepted by the Appellant on 5 May 2001.

8. By another letter dated 1 January 2002, Company E confirmed the Appellant's employment as company secretary on, inter alia, the following terms as from 1 January 2002:

> ' Remuneration
>
> | | | |
> |---|---|---|
> | Basic Salary | : | HK$20,000.00 per calendar month |
> | Housing Allowance | : | HK$25,000.00 per calendar month'. |

9. By a return dated 22 April 2002, Company E reported to the Revenue that during the period between 1 May 2001 and 31 March 2002, they had provided Property B as a place of residence for the Appellant. The Appellant had paid rent of $275,000 during this period and Company E had refunded the same to the Appellant. The issue before us relates to the taxability or otherwise of this sum of $275,000.

10. The Appellant maintains that she entered into a tenancy agreement with Madam A dated 21 May 2001 ['the Tenancy Agreement'] whereby Madam A let Property B to her for 12 months commencing from 1 May 2001 at the monthly rent of $25,000 per month. According to Clause 4 of the Tenancy Agreement, Madam A as landlord agreed 'to pay all water, gas and electricity charges and all meter rent for all gas electric and other meters installed at the said building'. A stamped copy of this tenancy agreement was placed before us although the date of the stamp chop is illegible. Company E informed the Revenue by letter dated 28 January 2002 that 'HK$25,000 has been paid to [the Appellant] each month as a housing allowance. She has provided the true copy of the stamped tenancy agreement ... and original monthly rental receipts'.

11. The Appellant produced two sets of rental receipts in support of her claim that she duly paid rent in favour of Madam A. According to the original set of rental receipts tendered by the Appellant, Madam A acknowledged rent of $25,000 inclusive of rates on 2 May 2001, 2 June 2001, 1 July 2001, 3 August 2001, 3 September 2001, 2 October 2001, 3 November 2001, 1 December 2001, 2 January 2002, 2 February 2002 and 1 March 2002. The receipts however

made it clear that water, electricity and management charges were to be paid by the Appellant. This is of course inconsistent with the Tenancy Agreement. The Appellant subsequently provided the Revenue with a fresh set of rental receipts deleting such reference.

12. In letter dated 12 May 2003 addressed to the Revenue, the Appellant made the following assertions:

(a) 'I need to rent the property. The property is not wholly owned by me, but I solely occupied the property. I have exclusive right to use the WHOLE property. The other joint owner, [Madam A], is of another residential address ...'

(b) 'I paid the landlord the rent in cash of HK$25,000 per month. Of which 50% mortgaged loan (equivalent to HK$17,526.87) plus HK$7,390 (sic), being the personal bank loan (explained below), was returned by the landlord to me at each time when the rent was paid. This is offsetting money owed by the landlord to me'.

(c) 'The mortgaged loan is debited my bank account. 50% of which should be contributed by the landlord. The personal loan belongs to [Madam A] and the loan statements are controlled and addressed to her directly ... The loan was granted by the bank together with the mortgage loan and repayment is made via my bank account. Please refer to my bank book record ...'.

13. The Appellant submitted a passbook to the Revenue to support her contentions. She highlighted the following entries for the Revenue's attention:

Transaction date	**Amount withdrawn**
19-4-2001	$35,053.74
2-6-2001	$7,390
19-6-2001	$35,053.74
3-7-2001	$7,390
19-7-2001	$35,053.74
2-8-2001	$7,390
20-8-2001	$35,053.74
3-9-2001	$7,323.29

The following computations were also inserted in the passbook:
$35,053.74/2 = $17,526.87
$17,526.87 + $7,390 = $24,916.87

14. In paragraph 5 of the Appellant's 'Statement of Ground of Appeal', the Appellant further asserted that:

> ' ... I would like to clarify that I have NEVER ADMITTED that "there was no actual payment of the alleged sums of rent". I contend that I paid [Madam A] a rent in cash of HK$25,000 per month in the Lease Period. With her instruction, an amount of HK$17,526.87 in cash was paid on her behalf for her share of the mortgage loan and HK$7,390 in cash for her personal bank loan. The balance of HK$83.1 was paid in cash to [Madam A] directly (except in September 2001, I paid HK$149.8). ... After the last repayment instalment of [Madam A's] personal loan ended on 3 September 2001, I paid HK$7,473.1 per month (being HK$7,390 + HK$83.1) to her who then repaid me HK$7,390 to cover the outstanding debt owed to me resulting from the personal bank loan I paid for and on her behalf via my bank accounts from 2 November 1997 to 2 April 1998. The balance of HK$83.1 was paid to [Madam A] by cash on the dates of payment as shown on the rental receipts ...'.

15. The Revenue argued that in giving Madam A her half share of the rental at $25,000 per month, the Appellant was in effect contending that the market rent for Property B was $50,000 per month. The Revenue pointed out that this was well above the figures depicted in various advertisements submitted by the Appellant.

16. At the hearing before us, the Appellant did not give any sworn testimony. She was content to explain her case to us along the lines outlined above. She was not prepared to be cross-examined on her assertions.

17. After completion of the evidence at the hearing on 10 July 2004, the Revenue tendered for our consideration a full written submission. The Appellant was obviously unprepared and we decided to give the Appellant time to respond to the Revenue's written submission. We also raised with the Revenue two new points (on section 61 and on interest deduction) which we wished to have the Revenue's further assistance. We therefore gave directions on the exchange of further written submissions between the parties. We made clear that such submissions must be based on evidence already before us and we do not entertain any attempt to produce fresh evidence.

(a) In response to our invitation, the Revenue submitted a written submission on the two new points on 16 July 2004. The Revenue also produced a set of new authorities in support of their submission. By letter dated 19 July 2004, the Appellant took exception to these authorities and invited us to reject the Revenue's submission of 16 July 2004. We informed the Appellant that the 16 July 2004 submission of the Revenue is within the perimeters of our directions. We invited the Appellant to respond to the same.

(b) On 30 July 2004, the Appellant submitted her written submission in respond to the Revenue's written submission tendered to us at the hearing on 10 July 2004. In accordance with our directions on 10 July 2004, the Revenue replied to the Appellant's submission on 5 August 2004. The Appellant again took exception to this reply. By letter dated 25 October 2004, we invited the Appellant to make further submission to the Revenue's reply. The Appellant maintained her objection by letter dated 5 November 2004.

18. We are of the view that the Revenue had adhered throughout to the directions we gave on 10 July 2004. Every opportunity was extended to the Appellant to respond to the Revenue's submission.

The applicable statutory provisions in the Inland Revenue Ordinance ('IRO')

19. 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 ...'.

20. 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 ....'

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

The relevant authorities

22. 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.

23. In Case No D33/97, IRBRD, vol 12, 228, the taxpayer purported to enter into lease agreements with his parents concerning two properties. Property X was owned by his parents. Property Y 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 X and Property Y 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'*. The Board further said at page 239 that

> *'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.'*.

24. The Appellant placed reliance on Case No D149/00, IRBRD, vol 16, 83 where the Board at page 98 pointed out that:

> *'... [the Revenue] contended that the Taxpayer did not pay rent because this merely involved debiting sums to his current account with Company F. We reject this argument. At all relevant times, the current account of the Taxpayer with Company F was in credit in the amount of between $4,480,000 and over $6,000,000. This amount represented substantial advances previously made by the Taxpayer for the benefit of Company F. We know of no authority, and none was submitted to us, that states that a payment of rent*

must be a direct physical act and cannot be satisfied by way of offsetting moneys owed by the lessor to the lessee'.

Our decision

25. The Appellant adduced no evidence on the state of account between the Appellant and Madam A prior to the inception of her employment with Company E. We do not know whether she was in occupation of Property B and if so the nature of her occupation. We do not know the manner whereby the two repaid Bank C the monthly instalments of $7,390 in respect of the $300,000 loan and $35,053.74 in respect of the $4,263,700 loan.

26. The Appellant referred to the $300,000 loan as 'The personal loan' of Madam A. This is ambiguous. The evidence before us is that the loan was extended by Bank C in favour of both the Appellant and Madam A. There is no evidence that Madam A made any direct payment in favour of the bank. On the contrary, the passbook submitted by the Appellant indicates that she shouldered responsibility for such payment. On the assumption of equal responsibility, what Madam A owed the Appellant was half of $7,390 amounting to $3,695. Coupled with her half share of the $35,053.74 instalment amounting to $17,526.87, what Madam A owed the Appellant each month in respect of mortgage repayments was $21,221.87. The Appellant had wholly failed to explain to us the reason why she attributed the full sum of $7,390 to Madam A. We are inclined to the view that the Appellant was merely trying to inflate the figures so as to match the sum of $25,000 being the housing allowance provided in her contract of employment with Company E.

27. Apart from bare assertions, the Appellant adduced no primary evidence to demonstrate the movement of funds between her and Madam A. This is particularly significant after full repayment of the $300,000 loan. In the absence of any cross examination, we are not prepared to accept her bland statements as summarised in paragraph 15 above.

28. We have not lost sight of the fact that there was a stamped tenancy agreement between the Appellant and Madam A and Company E acknowledged that such agreement was furnished to them by the Appellant. We accept that this is an important piece of evidence to consider the issue whether rent was indeed paid by the Appellant to Madam A. There are however other factors which suggest that little weight should be given to the Tenancy Agreement. First, the initial set of rental receipts is inconsistent with any genuine intent to abide by the Tenancy Agreement. Secondly, there is no evidence from Madam A indicating that she paid for the relevant outgoings so as to give credence to the second set of rental receipts.

29. Bearing all these factors in mind, we are not satisfied that the Appellant did in fact pay rent to Madam A pursuant to a bona fide tenancy agreement between them. This is sufficient to dismiss the Appellant's appeal. Should we be wrong on this issue, we would have decided in favour of the Revenue on its alternative case under section 61 of the IRO. We would have held that the Tenancy Agreement is an artificial or fictitious transaction which reduces or would reduce the

amount of tax payable by the Appellant or that it is a disposition which is not in fact given effect to and that the assessor is fully entitled to disregard the same.

30. For these reasons we dismiss the Appellant's appeal and confirm the assessment as indicated in paragraph 3(8) of the determination of the Deputy Commissioner of Inland Revenue dated 20 February 2004.