

Case No. D76/05

Salaries tax – home loan interest deduction – sections 26E & 26F of the Inland Revenue Ordinance ('IRO') – whether loan of money applied wholly or in part for the acquisition of a dwelling – whether appellant discharged burden of showing assessments were excessive.

Panel: Kenneth Kwok Hing Wai SC (chairman), Ivan Chu Siu Lun and K L Alex Lau.

Date of hearing: 17 February 2006.

Date of decision: 10 March 2006.

By an assignment dated 7 April 1992, a residential flat was assigned to the appellant and his wife as joint tenants at a consideration of HK\$2 million. Three weeks later, the appellant and his wife executed a legal charge in favour of a bank to secure general banking facilities granted to a company, in which the appellant and wife were the only directors and shareholders. This legal charge was discharged on 13 January 1996.

Subsequently, they obtained a term loan of HK\$600,000 from a finance company. By a mortgage dated 13 January 1996, they executed an all monies legal charge in favour of the finance company. On 16 July 1997, the finance company agreed to extend another term loan of HK\$3.6 million.

The assessments appealed against covered six years of assessment, from 1998/99 to 2003/04. The effect of the assessments was to withdraw home loan interest deductions originally allowed. At the hearing, the appellant relied upon an explanatory leaflet issued by the IRD on Home Loan Interest, and claimed that the interest paid on the three loans were deductible. Neither the appellant nor his wife gave evidence.

Held:

1. A deduction for home loan interest was introduced in 1998 by the addition of sections 26E and 26F in the IRO. In order to be deductible, the loan of money must have been applied wholly or partly for the acquisition of a dwelling. In other words, unless the acquisition of the dwelling was financed wholly or in part by a mortgage loan, the claims for deduction are bound to fail.

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2. On the facts, there was no allegation and no evidence that any of the three loans were applied wholly or in part for the acquisition of property. In addition, the first loan had already been discharged prior to the relevant period in this appeal. Accordingly, the appellant had failed to prove that the loans were 'home loans' within the meaning of section 26E of the IRO.
3. *Obiter*. Whether an appellant is entitled to a deduction is governed by statute, and leaflets issued by the IRD do not change the law, and is not binding on the Board. More importantly, the leaflet did state that the home loan interest must have been paid for acquisition of a dwelling. There was no allegation nor evidence that this was the case. On the basis of what is stated in the leaflet, the deduction would not be granted.

Appeal dismissed and costs order in the sum of \$2,500 imposed.

Taxpayer in person.

Lai Wing Man and Wong Kai Cheong for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal against the Determination of the Deputy Commissioner of Inland Revenue dated 4 October 2005 whereby:
 - (a) Additional salaries tax assessment for the year of assessment 1998/99 under charge number 9-2325682-99-8, dated 24 March 2005, showing additional net chargeable income of \$50,000 with additional tax payable thereon of \$8,500 was confirmed;
 - (b) Additional salaries tax assessment for the year of assessment 1999/2000 under charge number 9-2274344-00-4, dated 26 May 2005, showing additional net chargeable income of \$100,000 with additional tax payable thereon of \$16,617 was confirmed;
 - (c) Additional salaries tax assessment for the year of assessment 2000/01 under charge number 9-2308874-01-9, dated 26 May 2005, showing additional net chargeable income of \$56,334 with additional tax payable thereon of \$18,298 was confirmed;
 - (d) Additional personal assessment for the year of assessment 2000/01 under charge number 6-2308876-01-7, dated 26 May 2005, showing net chargeable

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income of \$318,766 with tax payable thereon of \$43,690 (the appellant's share being \$28,142) was confirmed;

- (e) Second additional salaries tax assessment for the year of assessment 2001/02 under charge number 9-3552231-02-5, dated 26 May 2005, showing additional net chargeable income of \$50,000 with additional tax payable thereon of \$8,500 was confirmed;
- (f) Personal assessment for the year of assessment 2001/02 under charge number 6-3551075-02-5, dated 26 May 2005, showing net chargeable income of \$449,859 with tax payable thereon of \$62,976 (the appellant's share being \$32,545) was confirmed;
- (g) Personal assessment for the year of assessment 2002/03 under charge number 6-2113383-03-8, dated 26 May 2005, showing net chargeable income of \$498,492 with tax payable thereon of \$74,243 (the appellant's share being \$35,881) was confirmed;
- (h) Additional salaries tax assessment for the year of assessment 2003/04 under charge number 9-1916124-04-A, dated 26 May 2005, showing additional net chargeable income of \$50,000 with additional tax payable thereon of \$9,250 was confirmed; and
- (i) Additional personal assessment for the year of assessment 2003/04 under charge number 6-1916142-04-3, dated 26 May 2005, showing net chargeable income of \$502,761 with tax payable thereon of \$82,285 (the appellant's share being \$41,567) was confirmed.

2. The appellant in B/R 83/05 ('the Husband') and the appellant in B/R 84/05 ('the Wife') are husband and wife. The two appeals were heard together.

The relevant facts

3. By an agreement dated 6 September 1986, the Husband agreed to purchase from the developer at a consideration of \$502,200 a residential flat then under construction. The appellant took out a loan, secured by an equitable mortgage, of \$450,000 from a finance company to finance the acquisition.

4. On completion of the construction, the residential flat ('the Property') was assigned to two persons as joint tenants, with the Husband as confirmor, by an assignment dated 10 June 1988. The Husband's equitable mortgage was discharged on the same date.

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5. The Husband and another person were the only shareholders and directors of a private company incorporated in Hong Kong on 27 August 1991 ('PrivateCo'), each holding one share of \$1 each.
6. By an assignment dated 7 April 1992, the Property was assigned to the Husband and the Wife as joint tenants at a consideration of \$2,000,000.
7. By a Mortgage dated 3 weeks later, that is, dated 28 April 1992, the Husband and the Wife executed a legal charge in favour of a bank to secure general banking facilities granted to PrivateCo ('the First Loan'). The legal charge was discharged on 13 January 1996.
8. The Husband and the Wife obtained from a finance company a term loan of \$600,000, repayable by 240 monthly instalments ('the Second Loan'). By a Mortgage dated 13 January 1996, the Husband and the Wife executed an all moneys legal charge in favour of the finance company. On 16 July 1997, the finance company agreed to extend another term loan of \$3,600,000, repayable by 360 monthly instalments ('the Third Loan').
9. The assessments appealed against covered six years of assessments, 1998/99 – 2003/04. The effect is to withdraw home loan interest deductions originally allowed.

Grounds of appeal

10. By letter dated 23 October 2005 which arrived at Office of the Clerk to the Board of Review on 28 October 2005, the Husband lodged his appeal. By letter dated 23 October 2005 which arrived at the Office of the Clerk to the Board of Review on 2 November 2005, the Wife lodged her appeal. Their grounds of appeal are the same and read as follows (written exactly as it stands in the original):

'We cannot agree with your "reasons of determination" therefore we shall object your determination based on the following facts.

From the very beginning till now, we have mentioned repeatedly in our various correspondences to you yet we have not received satisfactory replies from you.

1. When the Inland Revenue Department introduced the "Home Loan Interest Deduction Scheme" to the taxpayers sometimes in 1998, the Department had not excluded "interest incurred re-mortgaged loan", as long as the subject dwelling is for the residential purposes of the taxpayer.
2. The "Home Loan Interest Deduction Scheme" was introduced to reduce taxpayers' financial burden of whom, have difficulty to pay interest on their residential home due to whatever reasons such as: A. 1997 Asian Financial

Crisis, B. Collapse of the housing market started from 1997 thereon, C. Collapse of the stock market from 1998, D. Taxpayers wrong decision-makings on buying homes, investment and else during that period of time.

3. Interest incurred between “purchase of a new dwelling” and “re-mortgaged loan on an already-resided dwelling” does not make any change as far as wrong decision-making is concerned; so long as the subject dwelling is the single home for the taxpayer’s residential purposes, the taxpayer is entitled to apply for “home loan interest deduction scheme” during that period of time.’

The appeal hearing

11. At the hearing of the appeal, the Husband appeared in person. The Wife was absent but represented by the Husband. The respondent was represented by Ms Lai Wing-man, senior assessor.

12. The Husband submitted an extract from an undated Explanatory Leaflet issued by the Inland Revenue Department (‘IRD’) on Home Loan Interest and highlighted the words ‘on a loan *for acquisition* of the dwelling’ in the following passage:

‘Eligibility For Deduction

The following conditions must be satisfied before the deduction is granted:

- ? the person is the *owner* of the dwelling (as a sole owner, or as a joint tenant or tenant in common);
- ? the dwelling is a separate rateable unit under the Rating Ordinance, i.e. it is *situated in Hong Kong*;
- ? the dwelling is wholly or partly used by the person as his *place of residence* in the year of assessment;
- ? home loan interest is paid by the person during the year of assessment on a loan *for acquisition* of the dwelling;
- ? the loan is secured by a *mortgage or charge* over the dwelling or over any other property in Hong Kong; and
- ? the *lender* is the Government, a financial institution, a registered credit union, a licensed money lender, the Hong Kong Housing Society, the person’s employer,

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or any organization or association approved by the Commissioner of Inland Revenue.'

13. The Husband:
- (a) contended that 'acquisition of the dwelling' simply meant 'getting somewhere to live in' and was not restricted to 'interest related to the PURCHASE of the captioned dwelling';
 - (b) further contended that all loans secured by a mortgage of a residential property were covered, including cases where the loans were used for buying cars or speculating in property;
 - (c) asserted that the claims for deductions were based on the Leaflet; and
 - (d) claimed that the Wife had been under great stress because of the penalty by the IRD.
14. Neither the Husband nor the Wife nor the respondent called any witness.

The Board's Decision

15. Section 68(4) of the Inland Revenue Ordinance, Chapter 112, ('the Ordinance') provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.

16. Home loan interest deduction was introduced in 1998 by the addition of sections 26E and 26F to the Ordinance.

17. Section 26E(1) provides that:

'(1) Subject to the other provisions of this section and to section 26F, where a person pays during any year of assessment any home loan interest for the purposes of a home loan obtained in respect of a dwelling which is used at any time in that year of assessment by the person exclusively or partly as his place of residence, a deduction in respect of the home loan interest shall be allowable to that person for that year of assessment.'

18. 'Home loan interest' is defined in section 26E(9) to mean:

'...in relation to a person claiming a deduction in respect of a dwelling under this section, means interest paid by the person as a sole owner, or as a joint

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tenant or tenant in common of the dwelling for the purposes of a home loan to ... a financial institution ...

19. 'Home loan' is defined in section 26E(9) to mean:

'...in relation to a person claiming a deduction under this section 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 ... joint tenant ... 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*'.

20. 'Acquisition' is a common English word which is included in a children's dictionary.

21. The Oxford Children's Dictionary, second edition, published in 1985 by the Oxford University Press contains the following entry on 'acquire' and 'acquisition':

'acquire (acquires, acquiring, acquired) To get, to obtain. **Acquisition.**'

22. The New Oxford Dictionary of English published by the Oxford University Press in 2000 gives 'acquisition' the following meanings and examples:

'acquisition an asset or object bought or obtained, typically by a library or museum.

■ an act of purchase of one company by another.

■ [mass noun] buying or obtaining assets or objects: *western culture places a high value on material acquisition*

23. The Longman Dictionary of Contemporary English gives 'acquisition' the following meanings and examples:

'acquisition

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...

2 [uncountable] the act of getting land, power, money etc: *the acquisition of new territory*

3 [countable] formal something that you have bought or obtained, especially a valuable object: *The National Gallery's latest acquisition is a painting by Goya.*'

24. In the context of the definition of a 'home loan' in sub-section (9), the loan of money must have been applied wholly or partly for the acquisition of a dwelling. In other words, unless the acquisition of the dwelling was financed wholly or in part by a mortgaged loan, the claims for deduction are bound to fail.

25. There is no allegation and no evidence that the First Loan was applied wholly or partly for the acquisition of the Property. The Husband and the Wife have failed to prove that the First Loan was a home loan within the meaning of section 26E.

26. Furthermore, the First Loan was repaid and the security was discharged on 13 January 1996, before the relevant period in these appeals, that is, from 1 April 1998 to 31 March 2004.

27. There is no allegation and no evidence that the Second Loan was applied wholly or partly for the acquisition of the Property. The Husband and the Wife have failed to prove that the Second Loan was a home loan within the meaning of section 26E.

28. There is no allegation and no evidence that the Third Loan was applied wholly or partly for the acquisition of the Property. The Husband and the Wife have failed to prove that the Third Loan was a home loan within the meaning of section 26E.

29. Both the Husband's appeal and the Wife's appeal do not get off the ground.

30. For completeness, we will comment briefly on the grounds of appeal and the contentions.

31. Whether a taxpayer is entitled to a deduction is governed by the relevant provisions in the Ordinance which was enacted by the legislature.

32. The Leaflet cannot and does not change the law and is not binding on the Board of Review. More importantly, what is stated in the leaflet is that the 'following conditions must be satisfied before the deduction is granted ... home loan interest is paid by the person during the year of assessment on a loan *for acquisition* of the dwelling'. What the Leaflet was referring to was 'a

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loan for acquisition of the dwelling'. In other words, the loan must be for acquisition of the dwelling. There is no allegation and no evidence that any of the three loans was for acquisition of the Property. On the basis of what is stated in the Leaflet, the deduction would not be granted.

33. The argument that all loans secured by a mortgage of a residential property were covered, including cases where the loans were used for buying cars or speculating in property is unsupported by any authority and flies in the face of the definition of a 'home loan' under sub-section 9. Loans for buying cars or speculating in property are not among the reasons attributed by the Husband and the Wife to the scheme in their grounds of appeal.

34. What the Husband referred to as penalty was default interest under section 71(5) and (5A) of the Ordinance for not paying tax by the due dates. The Husband and the Wife chose to adopt a belligerent attitude and refused to pay the assessments appealed against. It will be a sad day for the revenue if tax is only payable at the pleasure of a taxpayer. IRD has been criticised by the Director of Audit for not being sufficiently diligent in enforcing payment of tax.

35. For reasons given above, both appeals will be dismissed and the assessments appealed against will be confirmed.

Disposition

36. We dismiss the Husband's appeal and confirm the assessments appealed against as confirmed by the Deputy Commissioner.

Costs

37. In 2004, the Husband objected against the assessor's refusal to correct under section 70A of the Ordinance the additional salaries tax assessment for the year of assessment 2001/02 and also against the salaries tax assessment for the year of assessment 2002/03.

38. By his Determination dated 7 May 2004, the Deputy Commissioner gave reasons why he did not think that the First Loan, the Second Loan and the Third Loan were home loans within the meaning of section 26E(9).

39. The Husband appealed to the Board of Review. The Board [(2005-06) vol 20, IRBRD, 37] refused to extend time for appeal and expressed the *obiter* view that the Husband had not discharged the onus of proving a home loan within the meaning of section 26E(1) and (9).

40. In 2004, the Wife objected against the assessor's refusal to correct under section 70A of the Ordinance the revised salaries tax assessment for the year of assessment 2001/02 and also against the salaries tax assessment for the year of assessment 2002/03.

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41. By his Determination dated 7 May 2004, the Deputy Commissioner gave reasons why he did not think that the First Loan, the Second Loan and the Third Loan were home loans within the meaning of section 26E(9).

42. Both the Husband and the Wife adopt a belligerent attitude, refuse to see reason and abuse the appeal process by pursuing these hopeless appeals.

43. Pursuant to section 68(9) of the Ordinance, we will order the Husband and the Wife to each pay the sum of \$2,500 as costs of the Board.

Costs Order

44. We order the Husband to pay the sum of \$2,500 as costs of the Board, which \$2,500 shall be added to the tax charged and recovered therewith.