

Case No. D80/05

Salaries tax – home loan interest deduction – beneficial owner as opposed to legal (registered) owner – sections 2 and 26E of the Inland Revenue Ordinance (‘IRO’).

Panel: Benjamin Yu SC (chairman), Clement Chan Kam Wing and Brossa Wong Yeuk Ha.

Date of hearing: 29 December 2005.

Date of decision: 28 March 2006.

The taxpayer contended that:

- His elder sister was registered as the owner of Address B (the ‘property’) as his nominee in January 2001.
- In respect of the property, mortgage loans had been obtained (an equitable one from October 1999 to January 2001 from Bank D and then legal ones in January 2001 from both Bank D as well as Company E which was not a financial institution). He paid for the purchase money and all instalments and interests payable under the various mortgages of the property.
- In late 2000 or early 2001, he obtained possession of the property which was then left vacant for about 2 months.
- His wife refused to move in yet he himself stayed in the property for a short while and over weekends.
- The property was then disposed of in October 2001.
- As the beneficial owner of the property, he should be entitled to home loan interest deduction under section 26E for the relevant years of assessment.

Held:

1. Under section 26E:
 - 1.1 The property in question must have been used by the taxpayer as his place

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

of residence; and

- 1.2 Home loan interest refers to the amount of interest paid by the taxpayer to a financial institution; and
- 1.3 Ownership is concerned with legal, as opposed to beneficial ownership in the property.
2. For the year of assessment 2000/01, the taxpayer failed to prove that he had used the property as his residence.
3. For the year of assessment 2001/02, the Board doubted whether the taxpayer (by staying short and over weekends) did use the property as his place of residence. Yet, as such evidence was not challenged; benefit of doubt would be given to the taxpayer.
4. Company E was not a financial institution, any mortgage interest paid to it could not be regarded as 'home loan interest'.
5. The taxpayer was not the legal owner of the property; he would not be entitled to claim any deduction of the mortgage interest paid to Bank D under section 26E.

Appeal dismissed.

Cases referred to:

D94/01, IRBRD, vol 16, 792
D108/02, IRBRD, vol 18, 45
D22/04, IRBRD, vol 19, 163

Taxpayer in person.

Chan Wai Yee and Wong Kai Cheong for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal by Mr A ('the taxpayer') against the determination by the Deputy Commissioner of Inland Revenue dated 16 September 2005.

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

2. The issue in this appeal is whether the taxpayer is entitled to claim deduction for home loan interest under section 26E of the **Inland Revenue Ordinance** ('IRO') in respect of the years of assessment 2000/01 and 2001/02 ('the relevant years of assessment').

The facts

3. During each of the two relevant years of assessment, the taxpayer claimed deduction for home loan interest in the sum of \$100,000. The property in respect of which he claimed to have paid home loan interest is Address B ('the property').

4. The registered owner of the property is Ms C. She is the taxpayer's elder sister. She became the registered and legal owner of the property by virtue of an assignment dated 5 January 2001. According to the record at the Land Registry, there was an equitable mortgage in favour of Bank D in October 1999. In January 2001, she executed a legal mortgage in favour of the Bank D and at the same time, entered into a second mortgage over the property with a company called Company E. That second mortgage was discharged in April 2001. The Land Registry records also disclose that she entered into an agreement to sell the property in September 2001. The sale was completed in October 2001.

Evidence

5. The taxpayer and his sister gave evidence before us. The taxpayer explained to the Board that he was looking for a flat as his matrimonial home after he got married in July 1999. The taxpayer decided to buy the property, which was then under construction, but, according to him, his wife was not favourably disposed to the purchase or the idea of living there. The taxpayer decided to ask his sister to be his nominee in the purchase.

6. It was also the taxpayer's decision to obtain loans from Bank D and Company E secured by the two mortgages on the property. The first loan was in the sum of \$1,270,000; and the second was in the sum of \$453,900. He paid all instalments and interests payable under the mortgages.

7. The taxpayer obtained possession of the property in late 2000 or early 2001. After obtaining possession, his wife still refused to move in the property. The property was left vacant for about two months. He himself only stayed in the property for a short while and over weekends. He discharged the second mortgage in April as he found the cost of borrowing on this mortgage to be too expensive. In August, the taxpayer signed a provisional agreement to sell the property, and later completed the sale.

8. The taxpayer called his sister to give evidence. She corroborated the taxpayer's evidence and affirmed that in 1999 she worked in a restaurant earning some \$6,000. She would

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

not have the means to buy the property. She confirmed she had not paid any money on the property and only lent her name to her brother.

The arguments

9. The taxpayer's contention can be shortly summarised. His case is that he was the beneficial owner of the property and therefore comes within the meaning of the term 'owner' as defined in section 2 of the IRO. As an 'owner' who paid home loan interest, he argued that he was entitled to deduction under section 26E during the relevant years of assessment.

10. Ms Chan for the Commissioner relied on a series of decisions of this Board (including D94/01, IRBRD, vol 16, 792; D108/02, IRBRD, vol 18, 45 and D22/04, IRBRD, vol 19, 163) to the effect that the word 'owner' in section 26E refers to a legal owner and does not include a beneficial owner.

11. In respect of the interest paid to Company E, Ms Chan made a further submission that the evidence disclosed that that company was not a financial institution within the meaning of section 2 of the IRO, so that interest paid to that company could not be regarded as 'home loan interest' as defined in section 26E(9) of the IRO.

12. In respect of the interest paid to Bank D, Ms Chan raised two further points:

- (1) She contended that on the evidence, the taxpayer only obtained possession in about January 2001, and moved in some two months later. As such, it is doubtful whether the taxpayer could properly apply for home loan interest for the year of assessment 2000/01;
- (2) she further made the point that on the evidence the amount of interest paid by to Bank D for the period from 5 January 2001 to 31 March 2001 was only \$24,695.59 and that paid for the period from 1 April 2001 to 19 October 2001 was \$44,948; and not the amount of \$100,000 claimed by the taxpayer for each of the years of assessment.

Provisions of the IRO

13. It is convenient to set out the relevant provisions of the IRO.

14. Section 26E provides as follows:

- '(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 purpose of a home loan obtained in respect of a dwelling which is used at*

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

any time in that year of assessment by the person exclusively or partly as his place of residence, a deduction in respect of home loan interest shall be allowable to that person for that year of assessment.

- (2) (a) *Subject to paragraphs (b) and (c) and subsection (3), a deduction allowable to a person under subsection (1) in respect of any home loan interest paid by the person during any year of assessment shall be -*
- (i) (A) *where the dwelling is used by the person exclusively as his place of residence during the whole of that year of assessment, the amount of the home loan interest paid;*
or...
- (b) *For the purpose of this section, where a dwelling is held by a person otherwise than as a sole owner, the amount of the home loan interest paid referred to in paragraph (a)(i) shall be regarded as having been paid –*
- (i) *where the dwelling is held by the person as a joint tenant, by the joint tenants each in proportion to the number of the joint tenants; or*
- (ii) *where the dwelling is held by the person as a tenant in common, by the tenants in common each in proportion to his or her share in the ownership in the dwelling.*
- (c) *For the purposes of paragraph (a), where a dwelling is held by a person otherwise than as a sole owner, the relevant amount specified in Schedule 3D referred to in paragraph a(ii) shall be regarded as having been reduced –*
- (i) *where the dwelling is held by the person as a joint tenant, in proportion to the number of the joint tenants; or*
- (ii) *where the dwelling is held by the person as a tenant in common, between the tenants in common each in proportion to his or her share in the ownership in the dwelling.’...*
- (9) *‘home loan’ in relation to a person claiming a deduction under this section for any year of assessment, means a loan of money which is –*

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (a) *applied wholly or partly for the acquisition of a dwelling which –*
 - (i) *during any period of time in that year of assessment is held by the person as a sole owner, or as a joint tenant or tenant in common; and*
 - (ii) *during that period of time is used by the person exclusively or partly as his place of residence; and*
- (b) *secured during that period of time by a mortgage or charge over that dwelling or any other property in Hong Kong.*

15. Section 2 of the IRO is the interpretation section. It starts, as such provision always does, with the phrase ‘unless the contrary otherwise requires’. There follows a series of definitions, one of which is ‘owner’, to mean:

‘in respect of land or buildings or land and buildings, includes a person holding directly from the Government, *a beneficial owner*, a tenant for life, a mortgagor, a mortgagee in possession, a person with adverse title to land receiving rent from buildings or other structures erected on that land, a person who is making payments to a co-operative society registered under the Co-operative Societies Ordinance (Cap. 33) for the purpose of the purchase thereof, and a person who holds land or buildings or land and buildings subject to a ground rent or other annual charge; and includes an executor of the estate of an owner.’ (italics added)

Findings

16. Having considered both the oral evidence as well as documentary evidence placed before this Board, we come to the following findings:

- (1) Ms C was the legal owner of the property from January 2001 to October 2001; but she held the property on trust for the taxpayer.
- (2) The taxpayer was the person who paid for the property and all expenses in connection with the purchase.
- (3) The taxpayer was the person who provided the money for the payment of interest on the mortgages taken out with Bank D and Company E.
- (4) Interest was paid to Bank D since October 1999 under the equitable mortgage in favour of the Bank, and continued to be paid after January 2001 when the

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

assignment was effected and there was a legal charge in favour of the Bank, up until October 2001 when the sale of the property was completed and the mortgage in favour of the Bank was discharged. The amounts of interest paid are as recorded in the statements at pages 30-37 of the R1 bundle.

- (5) Interest was also paid to Company E over a period from November 2000 to March 2001. The amounts of interest paid are as recorded in a statement at page 24 of the R1 bundle.
- (6) At the relevant time, Company E was not a financial institution within the meaning of the IRO.

17. One of the requirements of section 26E is that the property in question must have been used 'as (the taxpayer's) place of residence' at some time during the relevant year of assessment.

18. Although we accept the evidence of the taxpayer and his witness to the effect that the property was held by Ms C as a nominee for the taxpayer, and that it was he who paid for the purchase of the property and all the instalment and interest payments, we are not satisfied that the taxpayer used the property as his place of residence during the year of assessment 2000/01. We accept Ms Chan's submission that on the evidence, he did not even move into the property until some two months after January 2001, and the taxpayer has not proved that he had used the property as his residence during that year of assessment.

19. Indeed, we doubt whether he did use the property as his place of residence even during the year of assessment 2001/02. Under section 26E(9), where a person has more than one place of residence, the term 'place of residence' means the person's principal place of residence. The evidence that the taxpayer stayed at the property over weekends and that his wife had persistently refused to move to the property would suggest otherwise.

20. Although we have our doubts, we are prepared not to rest our decision on this issue. Since this aspect of the evidence was not subject to challenge by the Revenue, we shall give to the taxpayer the benefit of the doubt and proceed on the basis that he did use the property as his residence during the year of assessment 2001/02.

21. We accept Ms Chan's submissions that since Company E was not a financial institution, any interest paid to that company could not be regarded as 'home loan interest' within the meaning of section 26E of the IRO, and cannot be the subject of a claim for deduction.

22. We further accept Ms Chan's submission on the amount of interest. The documentary evidence shows that during the year of assessment 2001/02, the amount of interest paid to Bank D was \$44,948.09.

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

23. On the question of whether we should apply the definition of ‘owner’ in section 2 to the phrase ‘sole owner’ in section 26E of the IRO, we have already noted that there has been a number of previous decisions of the Board on this point. In all these decisions, the Board came to the conclusion that the phrase ‘sole owner’ has a different meaning from the word ‘owner’ under section 2. In Case No D108/02, the Board reasoned:

‘The definition of “owner” in section 2 of the IRO as including a beneficial owner is not preclusive. The word can have a different meaning where the context requires. We are of the view that the context in which the word “owner” is used in section 26E is such that it does not include a beneficial owner for the following reasons:

- (a) Firstly, the IRO should not be construed wider than is necessary to give effect to its intention.*
- (b) Secondly, the interests held by joint tenants and tenants in common are legal interests and applying the ejusdem generis principle the reference to a “sole owner” ought to be construed consistently as meaning the sole legal owner. This is reflected in the meaning of “home loan” in section 26E(9) where it is defined as a loan of money which is applied wholly or partly for the acquisition of a dwelling which is held by “... the person as a sole owner, or as a joint tenant or tenant in common”.*
- (c) Thirdly, one cannot ignore the word “sole” before “owner”. If owner in section 26E includes a beneficial owner, then the full phrase would be construed as meaning a “sole beneficial owner”. However, such a construction would create the absurd situation that where there was only one beneficial owner the provisions in section 26E(2)(b)(i) and (ii) and 26E(2)(c)(i) and (ii) would not apply but would apply if there were two or more beneficial owners even though there is no mechanism for determining how much the entitlement to deduct home loan interest should be reduced to reflect the extent of a person's beneficial ownership.*
- (d) Fourthly, a restrictive construction of the word “owner” allows section 26E to be applied with certainty whereas a broader construction so as to include beneficial owners creates uncertainty both as to the application and extent of the entitlement to deduct home loan interest.’*

24. We agree with those reasons. The law draws a distinction between legal ownership and beneficial ownership of properties. Sometimes, a person is both the legal and beneficial owner of a property. Sometimes, the legal ownership is held by one person whilst the beneficial interest

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

belongs to another. They do not always coincide. It seems to us that section 26E could not have been intended to apply *both* to legal *and* beneficial ownership. As pointed out in the reasoning of the Board in D108/02, in a case where a property is held by two joint owners but for the benefit of one single beneficial owner, there is no indication whether the deduction should be made on the basis of the single *beneficial* ownership, or on the basis of joint *legal* ownership. Further, in all cases where there are not the same number of legal and beneficial owners, the provisions are again unworkable if one must have regard not only to legal ownership but to beneficial ownership. This is because 26E(2)(b)(i) and (ii) and (c)(i) and (ii) ordain apportionment by reference to the number of joint tenants or tenants-in-common.

25. In our view, section 26E is concerned with legal, as opposed to beneficial, ownership in properties. This is evident from the use of the expressions 'held by', 'joint tenants' and 'tenants in common' in this section. Furthermore, legal ownership is a matter of title which can easily be ascertained. Beneficial ownership, on the other hand, could involve difficult questions of fact and law. It is rather unlikely that these provisions were intended to require the ascertainment of beneficial ownership in every case.

26. In the present case, the taxpayer was not the legal owner of the property. That being the case, we are of the view the taxpayer's challenge against this Determination must fail. In the circumstances, we would dismiss the appeal and confirm the assessments.