

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D87/03

Salaries tax – section 26E of the Inland Revenue Ordinance ('IRO') – home loan interest allowance - whether interest attributable to that part of the loan used to pay premium deductible - to what extent is the appellant entitled to deduct interest paid to bank that is attributable to another bank loan.

Panel: Ronny Wong Fook Hum SC (chairman), Fred Kan and Stephen Lau Man Lung.

Date of hearing: 16 October 2003.

Date of decision: 24 December 2003.

The appellant acquired property of the Hong Kong Housing Authority ('the Authority') by a loan of Bank A in 1985. The alienation of the said property was subject to the payment of a premium to the Authority. In 1997, the appellant borrowed a loan from Bank B secured by the said property to pay the premium to the Authority and from 1998 to 2001, the appellant paid interest under the Bank B loan and was granted various deductions under section 26E of the IRO.

In 2000, the appellant obtained from Bank C a loan with lower interest to discharge the Bank B loan. The appellant sought to deduct home loan interest said to have been paid under the Bank C loan.

The appeal raises two issues: (a) whether interest attributable to that part of the Bank B loan used to pay the premium in favour of the Authority is deductible under section 26E of the IRO and (b) to what extent is the appellant entitled to deduct interest paid to Bank C that is attributable to the Bank A loan.

Held:

1. The Board rejected a claim for deduction of interest on a loan applied for the purpose of removing a restriction on alienation. The reasons the Board adopted are that the restriction did not in any way hinder the appellant's use of the flat as his dwelling. The appellant did not acquire a new dwelling by paying the premium. What he did acquire via the premium was the right to alienate a flat which had always been his dwelling. The premium was the consideration for removal of the restriction over his subsisting dwelling (D2/01, IRBRD, vol 16, 121 followed).

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2. The Board is satisfied that the percentage of the Bank B loan to repay the amount due under the Bank A loan should likewise be applied to apportion the interest paid under the Bank C loan.

Appeal dismissed.

Case referred to:

D2/01, IRBRD, vol 16, 121

Yeung Siu Fai for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The appeal

1. By an agreement for sale and purchase dated 23 August 1985, the Appellant acquired Property 1 for \$356,100. Property 1 is part of a development by the Hong Kong Housing Authority [‘the Authority’]. It was assigned in favour of the Appellant on 16 November 1985 subject to the provisions of the Housing Ordinance (Chapter 283). The Appellant was therefore not at liberty to alienate Property 1 without payment of premium to the Authority.
2. The acquisition by the Appellant was financed in part by a loan of \$285,000 [‘the Bank A Loan’] extended on 9 October 1985 by Bank A. That loan was repayable by 180 monthly instalments of \$2,562 each.
3. After his acquisition, the Appellant moved into Property 1 and used the same as his dwelling.
4. In early 1997, the Appellant wished to remove the restriction against alienation attached to Property 1. By letter dated 23 January 1997, the Authority assessed the relevant premium at \$462,974 on the basis of the then market value of Property 1 at \$2,670,000.
5. By letter dated 14 November 1996, Bank B extended in favour of the Appellant a loan of \$1,620,000 [‘the Bank B Loan’] secured by Property 1. This loan was repayable by 240 monthly instalments of \$14,837.04 each. It was used by the Appellant for the following purposes:
 - (a) \$103,505 to discharge his then outstanding under the Bank A Loan.

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- (b) \$462,974 in favour of the Authority by way of premium to remove the restriction against alienation.
- (c) The balance was utilized by the Appellant for other investment purposes.

6. For the three years between 1998 and 2001, the Appellant paid the following amounts of interest under the Bank B Loan and he was granted various deductions under section 26E of the Inland Revenue Ordinance ['IRO']:

Year of assessment	Interest paid	Deduction claimed	Deduction allowed
1998/99	\$145,840.48	\$100,000	\$9,318
1999/2000	\$134,685.33	\$100,000	\$100,000
2000/01	\$70,700.25	\$100,000	\$100,000
	\$351,226.06		

7. On 2 September 2000, the Appellant obtained from Bank C a loan of \$1,500,000 ['the Bank C Loan']. The interest charged for the Bank C Loan is lower than the interest charged for the Bank B Loan. The Bank C Loan was used to discharge the Bank B Loan which stood at \$1,506,165.

8. In respect of the year 2001/02, the Appellant sought to deduct home loan interest in the sum of \$90,200 said to have been paid under the Bank C Loan. The actual amount of interest paid to Bank C during that year was \$89,175.

9. We are concerned solely with the Appellant's entitlement for the year 2001/02 although we recognize that our decision would affect the assessments in the preceding years which the Revenue has sought to re-open.

10. This appeal raises two issues:

- (a) whether interest attributable to that part of the Bank B Loan (\$462,974) used to pay the premium in favour of the Authority is deductible under section 26E of the IRO.
- (b) to what extent is the Appellant entitled to deduct interest paid to Bank C that is attributable to the Bank A Loan.

The premium point

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11. We are of the view that this case is indistinguishable from the decision of this Board in case no. D2/01, IRBRD, vol 16, 121. The Board there rejected a claim for deduction of interest on a loan applied for the purpose of removing a similar restriction. The Board said this:

‘The Taxpayer acquired the Flat as his dwelling in 1982. He did use the Flat as his dwelling and would be able to continue such usage without taking any other step. At the price paid, his acquisition was saddled with a restriction on alienation. That restriction does not in any way hinder his use of the Flat as his dwelling. The premium paid did not acquire a new dwelling. What he did acquire via the premium was the right to alienate a flat which has always been his dwelling. We reject the Taxpayer’s contention that the premium was in essence deferred consideration for the Flat. His initial purchase was at a consideration tied to restriction on alienation. The premium was not payment of deferred consideration for the acquisition of the Flat. The premium was the consideration for removal of the restriction over his subsisting dwelling.’

12. We are of the view that these reasons are equally applicable to the facts of this case. We reject any claim for deduction of interest attributable to that portion of the Bank B Loan which was used in payment of the premium.

The applicable deduction

13. The position is governed by section 26E(3)(a) of the IRO which provides:

‘Where any home loan interest is paid by a person during any year of assessment 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 that person exclusively or partly as his place of residence, but the loan was not applied wholly for the acquisition of the dwelling, the deduction allowable to the person under subsection (1) for that year of assessment in respect of the home loan interest paid shall be such part of the amount of the home loan interest paid as is reasonable in the circumstances of the case.’

14. The Revenue contends as follows:

- (a) Only 6.38% of the Bank B Loan was applied for the acquisition of Property 1. That percentage is arrived at as follows:

$$\frac{\$103,505.82 \text{ (amount due under the Bank A Loan)}}{\$1,620,000 \text{ (total amount of the Bank B Loan)}} \times 100\% = 6.38\%$$

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- (b) That percentage should likewise be applied to apportion the interest paid under the Bank C Loan with the result that the proper deduction for the year in question should be

$$\$89,175.03 \times 6.38\% = \$5,698.$$

15. The appellant contends that the relevant percentage is 36.3% arrived at as follows:

$$\frac{\$103,505.83 \text{ (amount due under the Bank A Loan)}}{\$285,000 \text{ (original amount of the Bank A Loan)}} \times 100\% = 36.3\%$$

16. We reject the contention of the Appellant. On his analysis 36.3% of the Bank B Loan amounting to \$588,060 ($\$1,620,000 \times 36.3\%$) would have been applied for the acquisition of Property 1. This does not accord with reality. We are satisfied that the formula adopted by the Revenue is reasonable in the circumstances.

17. For these reasons, we dismiss the appeal and confirm the assessment.