

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D90/99

**Personal Assessment Tax** – deductible – loan borrowed for the purpose of producing income – section 42(1) of the Inland Revenue Ordinance, Chapter 112.

Panel: Ronny Wong Fook Hum SC (chairman), Gerard Chung Wai Hung and Lily Yew.

Date of hearing: 23 September 1999.

Date of decision: 11 November 1999.

In 1985, the taxpayer and his son purchased under the Home Ownership Scheme a property for \$279,100 which was financed by granting a legal charge to a finance company. In 1996, the Director of Housing assessed the premium to be paid in order to remove the alienation restriction of the said property to be \$336,648. On 19 October 1996, the taxpayer and his son applied to and obtained from the same finance company a loan of \$1,379,000 (‘ the Relevant Loan ’) secured by the said property. The taxpayer and his son used part of the Relevant Loan to pay the premium on 12 November 1996.

By an agreement dated 14 October 1996, the taxpayer and his son purchased a new property for \$2,980,000. The new property was mortgaged in favour of a bank on 3 December 1996 to secure a loan of \$2,086,000. This left \$894,000 to be financed from other source.

By letter dated 22 February 1999, the taxpayer and his son informed the Revenue that the Relevant Loan was utilised as follows:

- (a) \$894,000 was used to pay the initial instalment in respect of the new property,
- (b) \$485,000 was used to pay the premium (\$341,848), legal fees and decoration charges in respect of the new property.

The Revenue accepts that interests in respect of that part of the Relevant Loan used to pay the premium are deductible under section 42(1) of the Inland Revenue Ordinance for the purpose of calculating the total income of the taxpayer. The issue was whether interests on the balance of the Relevant Loan amounting to \$1,042,352 [\$1,379,000 - \$336,648] is likewise deductible.

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### **Held:**

The sum of \$1,042,352 was not borrowed for the purpose of producing income from the said property. That sum was borrowed in order to finance the purchase of the new property.

### **Appeal dismissed.**

Cheung Lai Chun for the Commissioner of Inland Revenue.  
Taxpayer represented by his daughter-in-law.

### **Decision:**

1. By an agreement for sale and purchase dated 30 September 1985, the Taxpayer and his son purchased under the Home Ownership Scheme a unit at District A [ ' Property 1 ' ] for \$279,100.
2. By a legal charge dated 18 October 1985, the Taxpayer and his son charged Property 1 in favour of a finance company to secure a loan of \$250,000 advanced by the finance company to support the purchase of Property 1.
3. By an application dated 12 August 1996, the Taxpayer and his son applied to the Director of Housing for assessment of the premium required in order to remove the alienation restrictions over Property 1 imposed as part of the Home Ownership Scheme. By letter dated 3 October 1996, the Director of Housing assessed premium [ ' the Premium ' ] at \$336,648.
4. On 19 October 1996, the Taxpayer and his son applied to and obtained from the same finance company a loan of \$1,379,000 [ ' the Relevant Loan ' ] secured by Property 1. The Relevant Loan is repayable by 300 monthly instalments of \$11,809.1 each.
5. The Taxpayer and his son used part of the Relevant Loan to pay the Premium on 12 November 1996. The restrictions on alienation over Property 1 were removed by letter of the same date.
6. By an agreement dated 14 October 1996, the Taxpayer and his son purchased a unit at District B [ ' Property 2 ' ] for \$2,980,000. Property 2 was mortgaged in favour of a bank on 3 December 1996 to secure a loan of \$2,086,000. This left \$894,000 to be financed from other source.

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7. By a tenancy agreement dated 19 January 1991, Property 1 was let to a tenant for a period of two years with rent at \$10,000 per month.

8. By letter dated 22 February 1999, the Taxpayer and his son informed the Revenue that the Relevant Loan was utilised as follows:

- (a) \$894,000 was used to pay the initial instalment in respect of Property 2,
- (b) \$485,000 was used to pay the Premium (\$341,848), legal fees and decoration charges in respect of Property 2.

9. The Revenue accepts that interests in respect of that part of the Relevant Loan used to pay the Premium are deductible under section 42(1) of the Inland Revenue Ordinance for the purpose of calculating the total income of the Taxpayer. The issue before us is whether interest on the balance of the Relevant Loan amounting to \$1,042,352 [\$1,379,000 - \$336,648] is likewise deductible.

10. Section 42 of the Inland Revenue Ordinance provides that :

*'For the purposes of this Part the total income of an individual for any year of assessment shall, subject to subsection (8), be the aggregate of the following amounts-*

- (a) (i) ...
- (ii) *in respect of the years of assessment commencing on or after 1 April 1983, the sum equivalent to the net assessable value as ascertained in accordance with section 5(1A) and 5B ...*

*Provided that there shall be deducted from that part of the total income arising from paragraph (a) the amount of any interest payable on any money borrowed for the purpose of producing that part of the total income where the amount of such interest has not been allowed and deducted under Part IV.'*

11. Is the sum of \$1,042,352 borrowed for the purpose of producing the income arising from Property 1 so as to permit interest on that sum to be deducted from the total income? We are of the view that the stance of the Taxpayer as outlined in his letter dated 22 February 1999 (paragraph 8 above) clearly indicates that a negative answer should be given to this question. The sum of \$1,042,352 was not borrowed for the purpose of producing income from Property 1. That sum was borrowed in order to finance the purchase of Property 2.

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12. For these reasons, we dismiss the Taxpayer' s appeal and confirm the assessment.