INLAND REVENUE BOARD OF REVIEW DECISIONS

**Case No. D92/95**

**Salaries tax** – whether money rental refund.

Panel: Andrew J Halkyard (chairman), Michael Neale Somerville and Edwin Wong.

Date of hearing: 23 November 1995.
Date of decision: 3 January 1996.

The taxpayer claimed that money paid to him by his employer was a rental refund within the meaning of section 9(1A) of the Inland Revenue Ordinance, and therefore should only be assessed under special provisions of section 9(2). The taxpayer submitted a copy of the lease and all relevant rent receipts to his employer. A contribution to the cost of housing was provided for in the contract of employment.

Held:

The ordinary meaning of 'refund' connotes a repayment or reimbursement, not merely payment. On the basis of the facts, the money paid by the employer to the taxpayer amounted to refunds of rent.

**Appeal allowed.**

Cases referred to:

D8/82, IRBRD, vol 2, 8
D62/92, IRBRD, vol 8, 85

K A Lancaster for the Commissioner of Inland Revenue.
Taxpayer in person.

**Decision:**

The Taxpayer has appealed against a determination of the Commissioner of Inland Revenue in relation to the salaries tax assessments for the years of assessment 1991/92 and 1992/93 raised on him. The Taxpayer claims that money paid to him by his employer, which was fully assessed to Salaries Tax, was a rental refund within the meaning of section 9(1A) of the Inland Revenue Ordinance ('the IRO') and therefore the rental benefit derived by him should only be assessed under the special provisions of section 9(2).

**The facts**

1. At all relevant times the Taxpayer was employed in Hong Kong by a company ('the Employer'). His letter of appointment, which was dated 16 August 1990, stated that:

> 'Your commencing salary will be at the rate of $28,500 per month which would include a contribution towards the cost of housing. Salaries are reviewed annually on 1 April.
>
> … Until you have found alternative accommodation, we will meet reasonable hotel expenses incurred, up to a maximum period of three weeks.'

2. On 23 November 1990 the Taxpayer entered into a tenancy agreement to rent a flat ('the Property'). The lease was for an initial period of two years at a monthly rent of $15,000.

3. On 1 April 1991 the Financial Controller of the Employer wrote to the Taxpayer in the following terms:

'Salary. $15,000 per month payable in arrears. …

Housing Allowance. [The Employer] will pay the rent or reimburse for the rent paid by you for your accommodation up to $15,000.'

4. Also on 1 April 1991 a director of the Employer wrote to the Taxpayer in the following terms:

> 'On behalf of the Directors, I am pleased to inform you that with effect from 1 April 1991, you would be appointed as manager … on the following terms and conditions:

Salary. $30,000 per month payable in arrears.'

5. On 27 September 1991 the Financial Controller of the Employer wrote to the Taxpayer in the following terms:

> 'On behalf of the Directors, I would like to advise you that with effect from 1 October 1991, your salary will be adjusted to $31,000 per month.'

6. On 1 April 1992 a director of the Employer wrote to the Taxpayer in the following terms:

> 'I am pleased to advise that with effect from 1 April 1992, [we invite you] to become an Associate Director [of the Employer] in Hong Kong. …
>
> Salary. You would be entitled to a package of $34,000 of which you would be allowed to split into a salary and housing elements in a tax effective manner…Please discuss this with [the Financial Controller].'

7. On 22 April 1992 and 21 April 1993 the Employer filed employer's return with the Inland Revenue Department ('the IRD') in respect of the Taxpayer for the years ended 31 March 1992 and 1993. Those returns showed the following particulars:

| | | |
|---|---|---|
| (a) | Quarters provided: | The Property |
| (b) | Nature: | Flat |
| (c) | Period provided: | 1-4-91 to 31-3-92<br>1-4-92 to 31-3-93 |
| (d) | Rent paid to landlord by Employer: | $180,000 (for 1991/92)<br>$223,752 (for 1992/93) |

8. In his salaries tax returns for the years of assessment 1991/92 and 1992/93 the Taxpayer disclosed the same particulars as those set out in fact 7 except that paragraph (d) stated:

| | | |
|---|---|---|
| (d) | Rent refunded to me by my Employer: | $188,364 (for 1991/92)<br>$304,806 (for 1992/93) |

9. On 15 September 1993 the Employer filed with the IRD an amended employer's return in respect of the Taxpayer for the year ended 31 March 1993. This document repeated the same details shown at fact 7 except that paragraph (d) stated:

| | | |
|---|---|---|
| (d) | Rent refunded to Employee: | $304,800 |

10. At the end of each month the Employer paid the following sums of money into the Taxpayer's bank account through autopay:

| | | |
|---|---|---|
| (a) | April 1991 to September 1991 | $30,000 |
| (b) | October 1991 to March 1992 | $31,000 |
| (c) | April 1992 to March 1993 | $34,000 |

11. In response to enquiries raised by the assessor in relation to the sums of rent claimed to have been paid or refunded by the Employer, the Employer gave a series of statements which were both confusing and inconsistent with earlier statements. For example, at different times the Employer stated:

    (a) For the year ended 31 March 1992

    For the period 1 April to 30 September 1991 the salary paid, by way of autopay, to the Taxpayer amounted to $15,000 per month and from 1 October 1991 to 31 March 1992 this amount was increased to $16,000 per month.

    The monthly housing allowance was $15,000.

    (b) For the year ended 31 March 1993

    For the period 1 April to 30 November 1992 the salary paid to the Taxpayer amounted to $18,031 per month and the amount of rent refund was $15,969 per month (total $34,000 per month) and from 1 December 1992 to 31 March 1993 the salary was reduced to $10,000 per month and the rent refund increased to $24,000 per month (total $34,000 per month).

12. At all relevant times the Taxpayer paid rent to the landlord of the Property in the amount of $15,000 per month.

13. The assessor took the view that the alleged rental benefit reported by the Employer in the employer's returns (facts 7 and 9 refer) and by the Taxpayer in the salaries tax returns (fact 8 refers) were in fact allowances which should be fully chargeable to salaries tax.

14. The Taxpayer lodged valid objections to the salaries tax assessments for the years of assessment 1991/92 and 1992/93 raised by the assessor. In support of the objections the Taxpayer contended that his terms of employment with the Employer included a contribution to his housing expenses; that he claimed refund of rent from the Employer by submitting rental receipts; and thus he should only be taxed on the rent refund in accordance with the provisions of sections 9(1A) and 9(2).

15. On 2 May 1995 the Commissioner dismissed the Taxpayer's objection. In the determination the Commissioner concluded that at all relevant times the Employer paid a fixed monthly sum to the Taxpayer, of which no part could be treated as rent refund, and that the whole sum should be chargeable to tax. The Commissioner noted the many inconsistencies in the documents before him. He concluded that the Employer was not at all concerned about the amount of rent, if any, incurred by the Taxpayer before a purported refund was made to the Taxpayer. In the Commissioner's view the Employer had simply attempted, but had failed, to relieve the Taxpayer's tax liability. The

Commissioner stated that he could not accept any arbitrary tax minimisation device.

16. On 1 June 1995 the Taxpayer appealed against the Commissioner's determination to this Board. The ground of appeal was that the rental benefit provided to the Taxpayer by the Employer was a rent refund which should only be assessed under the special provisions of section 9(2).

**The Taxpayer's evidence**

During the course of the Board hearing the Taxpayer gave oral evidence. On the basis of that testimony and various documents produced before the Board, we find the following additional facts.

17. A copy of the lease for the Property was shown by the Taxpayer to the Employer when he first rented the Property. The lease was retained by the Taxpayer for safe keeping. At the end of each month or at the latest before the end of each year of assessment all relevant rent receipts for the Property were submitted by the Taxpayer to the Employer. The Employer subsequently made copies of these available to the IRD.

18. A contribution to the cost of housing amounting to $15,000 per month payable by the Employer to the Taxpayer was agreed to orally once the Taxpayer arrived in Hong Kong. The exact cost of housing was not ascertained at the time the employment contract was signed (fact 1 refers) because at that time the Taxpayer was in the United Kingdom and he wanted to have it fixed when he arrived in Hong Kong.

19. The discrepancies in the amounts set out at facts 7, 8 and 9 were explained as follows:

    (a) For the year ended 31 March 1992 the actual rent paid by the Taxpayer amounted to $15,000 x 12 (total $180,000); the management fees paid by the Taxpayer amounted to $8,364 and were wrongly claimed in the salaries tax return for the year of assessment 1991/92 (fact 8 refers) as refunds of rent.

    (b) For the year ended 31 March 1993 the actual rent paid by the Taxpayer amounted to $15,000 x 12 (total $180,000); the management fees paid by the Taxpayer amounted to $10,116; and furniture and electrical appliances were purchased by the Taxpayer in the amount of $33,635 (grand total $223,751). The difference between this figure of $223,751 and $304,806, the amount which was claimed by the Taxpayer per fact 8 as a rental refund, was referable to expenditure that the Taxpayer incurred for travelling which was not reimbursed by the Employer. The Taxpayer was unable to explain how, in the absence of supporting

receipts, the Employer could have included the figure of $304,800 in the employer's return as a refund of rent (fact 9 refers). He also did not explain why he wrongly recorded this amount in his salaries tax return as a claimed refund of rent. The Taxpayer did however acknowledge that he had made a mistake in his salaries tax return and he now accepts that the discrepancy between the rent of $180,000 and the sum of $304,806 is properly subject to salaries tax.

(c) Nor was the Taxpayer able to explain how the Employer could have stated (fact 11(b) refers) that as from 1 December 1992 to 31 March 1993 his salary was reduced to $10,000 per month and the rent refund increased to $24,000 per month.

(d) The Taxpayer was also unable to explain why the Employer in its employer's returns (fact 7 refers) stated that rent was paid 'to **landlord** by Employer'.

20. When questioned upon the terms of the letters set out in facts 5 and 6, the Taxpayer could not respond why he did not inform the director of the precise position that, as he understood it, his remuneration package should be split into salary and a rental refund or reimbursement. The Taxpayer simply replied that the letters were written by the Employer's senior management and that the administration personnel undertook the fine tuning of his total remuneration package.

**Contentions for the Taxpayer**

At the outset, the Taxpayer admitted that he made various mistakes when filling out his salaries tax returns. However, he stated it was common ground that he paid rent for the Property of $180,000 ($15,000 x 12) for each year in dispute. The Taxpayer clarified that these were the only sums for which he claimed that he received a rent reimbursement or refund from the Employer.

The Taxpayer then drew the Board's attention to his appointment letter (fact 1 refers). He argued that where an employer has designated part of an employee's remuneration package as a rental benefit and has sought and received receipts which indicate that the amount designated for rental purposes has been properly expended for the designated purpose of providing reimbursement of rental, then that amount is clearly a rental reimbursement and should only be assessed under the provisions of sections 9(1A) and 9(2).

The Taxpayer argued that it was irrelevant that the appointment letter did not state how and in what form the rental benefit should be paid. In the Taxpayer's view, this was simply a detail of the remuneration package which was delegated by the Employer's senior management to the administration personnel. Moreover, when he signed the letter the exact cost of housing was not ascertained because at that time he was in the United

Kingdom and he wanted to, and ultimately did, have it fixed when he arrived in Hong Kong (fact 18 refers).

Turning to the letters set out in facts 4 and 5 the Taxpayer contended that they related to increases in his total package and did not effect the underlying terms of his employment (see also fact 6 which, in the Taxpayer's view, indicates that senior management decided the level of the total remuneration package and left the allocation to administrative staff).

The Taxpayer then drew the Board's attention to the following passage in Ernst & Young, **Taxation in Hong Kong** (1991/92 edition) at page 286:

> *'Housing allowances are by definition subject to salaries tax. However, in practice, where an employer … pays a regular monthly housing allowance to the employee and exercises sufficient control over the manner in which that allowance is spent (that is, such an allowance is effectively a refund of rent and not merely an additional emolument to be spent in any manner the employee may desire), such housing allowance is not assessable and the assessable rental value of the accommodation is determined under section 9(1)(b) or (c). A sufficient control by the employer is achieved where the allowance does not exceed the actual rental expenses incurred by the employee and the employer maintains sufficient records of the rental receipts.'*

The Taxpayer seeks to apply this passage to his case by arguing that his remuneration package was at all times allocated between salary and contribution to rent and that sufficient control was exercised by the Employer which required him to submit all relevant rental receipts.

The Taxpayer then referred to correspondence with the assessor in which reference was made to the assessor's statement that '… the amount of rental allowance was made by reference to the amount of rent actually paid by you'. Although the Taxpayer accepts that before this Board the Commissioner is not bound by this statement, he argues that the clear facts before us are: that receipts were produced to the Employer, a lease was seen by the Employer, sufficient control was exercised by the Employer within the terms of the generally accepted practice in Hong Kong and that the question whether he would have continued to receive the full amount of his package without the production of receipts is hypothetical and irrelevant to his case.

**Contentions for the Commissioner**

The Commissioner essentially argued this appeal on two levels. The first, very broad, argument was based upon the proposition that in deciding whether a sum paid is a reimbursement it is necessary to consider whether the sum would have been paid regardless of whether expenditure was incurred. According to the Commissioner, the Taxpayer must prove that the sums in dispute were only paid to him to reimburse or refund his rent and **only** on condition that he actually paid rent. In the Commissioner's view, if the sums would have

been paid to the Taxpayer regardless of whether he paid rent, then for the Employer simply to describe the amounts as refunds or reimbursements is mere labelling.

The second level of argument was based upon the proposition that the documents show the Taxpayer was paid a stated monthly salary in the following amounts (facts 4, 5 and 6 refer):

| | | |
|---|---|---|
| (a) | April 1991 to September 1991 | $30,000 |
| (b) | October 1991 to March 1992 | $31,000 |
| (c) | April 1992 to March 1993 | $34,000 |

The Commissioner argued that these were exactly the amounts paid by the Employer, by way of autopay, into the Taxpayer's bank account (fact 10 refers). No part of these amounts were paid because the Taxpayer paid rent. In the Commissioner's view the agreement between the parties was not that the Employer would refund rent to the Taxpayer but rather that the Taxpayer could split his salary to minimise his tax. This is highlighted by the numerous discrepancies and misdescriptions in the documents submitted before the Board (see, for example, facts 19 and 20). In this regard, the submission of lease agreements and rent receipts to the Employer by the Taxpayer was irrelevant because in reality the Employer exercised little or no control over the alleged refunds or reimbursements. In summary, the Employer was not concerned whether any amount was refunded to the Taxpayer. The Employer was simply prepared to allow the Taxpayer to treat amounts as if they were refunds in order to minimise the Taxpayer's tax bill.

**The issue in dispute**

The issue for decision by the Board has been considered by a previous Board of Review in D8/82, IRBRD, vol 2, 8, 10 where it was stated:

> *'If a place of residence is not provided by the employer or an associated company, the taxpayer must be able to show that the sum he has received and claimed by him as a [rental benefit] is a rental refund, either wholly or in part, which would entitle him to such tax relief as mentioned in section 9(1A)(a), (1)(b) or (c) of the [IRO].'*

Thus, the sole matter for decision by the Board is whether any part of the payments set out at fact 10 constitute refunds of rent within section 9(1A)(a).

**Analysis**

We reject the broader argument raised by the Commissioner that the amounts in dispute cannot be classified as refunds because they would have been paid in any event. The substance of the agreement entered into between the Taxpayer and the Employer (fact 1 refers) is clear--the Taxpayer was offered a lump sum package, which in total could not

exceed $28,500 per month. This package consisted of a wage **plus** housing benefit in an amount to be determined when the Taxpayer arrived in Hong Kong and when he had decided on appropriate accommodation.

In this regard, we have accepted the Taxpayer's evidence that he orally agreed with the Employer that the amount of this benefit would be $15,000 per month (fact 18). This is not, in our view, inconsistent with the clear thrust of the appointment letter set out at fact 1. Accordingly, the question of whether he would have continued to receive the full amount of his package if he had not rented the Property for $15,000 per month is hypothetical. It must follow that we also reject the Commissioner's argument that the wording in that letter, that the sum of $28,500 per month 'would include a contribution to the cost of housing', was simply added for no more than clarification that the Taxpayer would receive no extra amount for housing.

We are therefore left to decide the narrower ground argued by the Commissioner, *that is,* that the Taxpayer simply received a stated salary or a salary and an allowance for rent and that no part of the payments made to the Taxpayer could be properly described as refunds or reimbursements of rent.

We appreciate that the terms of the letters set out at facts 4, 5 and 6 state that the Taxpayer would be paid a lump sum salary. Indeed, the major difficulty in this case is that the various documents issued by the Employer were both confusing and inconsistent. But, having considered the terms of all of these documents and the other evidence before us, we agree with the Taxpayer that these letters related to increases in his total package. They did not effect the underlying terms of his employment, which clearly was intended to confer upon him a rental benefit which, in the result, was agreed to be $15,000 per month.

The ordinary meaning of 'refund' connotes a **repayment** or **reimbursement** (Shorter Oxford English Dictionary), not mere payment. On the basis of the facts we have found: *that is,* the Taxpayer paid rent at all relevant times of $15,000 per month, he submitted a copy of the lease and all relevant rent receipts to the Employer, his original contract of employment provided for a contribution to the cost of housing and, finally, an amount of $15,000 per month was agreed upon when the Taxpayer arrived in Hong Kong and suitable accommodation was found by him, we think it clear that the payments of $15,000 per month made by the Employer to the Taxpayer amounted to refunds of rent.

It does not avail the Commissioner to argue that the payments were simply allowances because, even if they were, section 9(2) states explicitly that if they were nonetheless refunds of rent, they are not taxable otherwise than in accordance with section 9(2). And, as noted above, in our view these payments were by way of refund.

We would like to make two final points. First, we fully understand the reasoning behind the Commissioner's determination and the Commissioner's argument before us that, on the basis of the considerable number of inconsistent statements made by the Taxpayer and the Employer, the Employer simply did not care how the rental benefit was spent, that the Employer exercised minimal (if any) control over this matter, and that

this looks like a colourable device simply to save tax for the Taxpayer. It is true that the Taxpayer and the Employer took a cavalier approach in many of their dealings with the IRD. It is hardly surprising, therefore, that the IRD took a sceptical approach when evaluating the claims made by the Taxpayer. He, together with the Employer, are the agents of his own misfortune. However, had the Commissioner known the additional facts brought out at this hearing, we trust he may have decided the matter differently.

Second, this is not a case like other typical precedents (see, for example, D62/92, IRBRD, vol 8, 85 where alleged rental refunds were well in excess of the rental payments or D8/82, IRBRD, vol 2, 8 where it was unclear what, if any, rent had to be paid by the taxpayer). Rather, the Taxpayer's case seems to us to fall substantially within the Commissioner's pragmatic stance in assessing rental benefits as set out in the passage extracted from Ernst & Young, **Taxation in Hong Kong** (reprinted above). Assuming, as we do, that this passage accurately describes IRD assessing practice, it strikes us that the Taxpayer falls fairly within it.

In the event, we allow the appeal. The amounts in dispute, that is, $15,000 per month from 1 April 1991 to 31 March 1993, should properly be classified as refunds of rent and the rental benefit derived by the Taxpayer should be assessed under the provisions of section 9(2).