

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D21/91

Personal assessment – deduction of interest – section 42(1) of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Vincent Liang Wan Sang and Patricia Loseby.

Date of hearing: 8 May 1991.

Date of decision: 24 June 1991.

The taxpayer purchased certain property and borrowed money from his mother-in-law for this purpose. In respect of two years of assessment, the taxpayer applied for personal assessment and sought to deduct from his total assessable income a sum which he claimed he had paid to his mother-in-law by way of interest on the loan which she had made to him. The taxpayer was unable to appear before the Board as he was resident overseas. The Commissioner disputed the claim of the taxpayer that he had paid interest to his mother-in-law.

Held:

The onus of proof is on the taxpayer. As the taxpayer was unable for good reason to give evidence, the Board should be sympathetic towards the taxpayer. On the evidence before the Board, there was clear evidence that the taxpayer had not actually paid interest to his mother-in-law and there was not sufficient evidence before the Board to prove otherwise.

Appeal dismissed.

J R Smith for the Commissioner of Inland Revenue.

Taxpayer in absentia.

Decision:

This is an appeal by a taxpayer against the refusal by the Deputy Commissioner to allow him to deduct certain interest which he claimed he had paid to his mother-in-law. The appeal was heard in the absence of the Taxpayer who is now resident in Canada. The Taxpayer said in correspondence that he had endeavoured to return to Hong Kong to present his case in person but had not been able to do so. He indicated to the Board in a very open and honest manner that he would not be able to visit Hong Kong until 1993 and it was

## INLAND REVENUE BOARD OF REVIEW DECISIONS

obviously not possible to delay the hearing of the case for such a long period of time. Accordingly the Board decided to proceed to hear the appeal in the absence of the Taxpayer.

We would like to place on record our appreciation to Mr Smith, the assessor who appeared before the Board to represent the Commissioner. He took the point of view that the Taxpayer should pay no more and no less than the correct amount of tax and so far as possible should not be prejudiced by his inability to appear in person before the Board. Mr Smith freely and openly answered all of the questions which were raised by the members of the Board and placed before the Board all of the relevant facts which were known to the Inland Revenue Department in an impartial manner. The facts of this appeal are indeed complex and the Board would not have been able to understand or indeed unravel the case without the assistance of Mr Smith.

To understand the case it is necessary to go back in history before the year of assessment in question and to ascertain how the situation arose which has led to the appeal. The facts as we find them are as follows:

1. The Taxpayer was a member of a family unit comprising his wife, his wife's mother and father. Both the Taxpayer and his wife were qualified accountants and enjoyed considerable trust from the wife's mother and father. It was on this basis that the mother-in-law of the Taxpayer was prepared freely to lend to him and her daughter any moneys which she had available.
2. As a result of certain events which are not material to this appeal the Taxpayer received enquiries from the Inland Revenue Department with regard to the financial arrangements which existed between him and his mother-in-law in relation to moneys which his mother-in-law had provided to him to assist him in purchasing property. The Taxpayer was an employee of the Hong Kong Government and appears to have sought the advice and assistance of the officers in the Inland Revenue Department with regard to how to handle his tax affairs. With great efficiency the officers of the Inland Revenue Department acting on the information given by the Taxpayer informed the Taxpayer that he should submit an interest tax return in which he should account to the Inland Revenue Department for tax withheld on interest payable to his mother-in-law. He proceeded to file such a return and to pay real tax to the Inland Revenue Department on notional interest which was stated to have been paid or to be payable to his mother-in-law.
3. In reality no such interest had been paid to his mother-in-law and there was no clear agreement between his mother-in-law and himself that interest would be payable. In fact the loan was an informal family arrangement. As a result of enquiries made by the Inland Revenue Department the true state of affairs was ascertained and the money which the Taxpayer had paid to the Inland Revenue Department as alleged tax withheld from interest was refunded to the Taxpayer. However when the Inland Revenue Department informed the

## INLAND REVENUE BOARD OF REVIEW DECISIONS

Taxpayer that he was not liable to account for tax on Interest which had not been paid to or accrued due to his mother-in-law, a letter was issued to him which read as follows:

‘I refer to your letter of 20 August 1987.

Since there is no actual cash payment or effective credit of the interest of \$54,000 having been made to the lender, no interest tax liability whatsoever arises. Accordingly the interest tax on \$54,000 previously paid by you will have to be refunded. Please therefore return to me the original Tax Deduction Certificate (BIR91) for process of the refund.

However, I must stress that whenever there is any actual cash payment, or effective credit made to the lender, interest tax at the standard rate then in force will have to be deducted from the gross interest, and remitted to this Department within thirty days from such date of payment or credit. In this respect, I again enclose herewith an information note (IR22) for your attention. Please also acknowledge receipt of this note.’

4. On 13 October 1984 the Taxpayer purchased certain property and borrowed from his mother-in-law a sum of \$300,000.
5. The property purchased by the Taxpayer for which the \$300,000 was used was assessed to property tax in respect of the years of assessment 1985/86 and 1986/87. In respect of each of these two years of assessment the Taxpayer applied for personal assessment and sought to have deducted from his total assessable income a sum which he claimed had been paid to his mother-in-law by way of interest on the loan of \$300,000.
6. Enquiries were made of the mother-in-law with regard to the alleged payment of interest on the loan of \$300,000. Her husband answered the enquiry and informed the Inland Revenue Department that the loan of \$300,000 was not an interest bearing transaction but was the result of a verbal arrangement and no interest had actually been paid or credited. This was confirmed by the Taxpayer himself who stated that the \$300,000 was not an interest bearing transaction and was purely a verbal promise under an internal family arrangement. He pointed out to the Inland Revenue Department that he had been advised or it had been suggested that he should pay interest tax previously. He had done as had been suggested and subsequently the interest tax had been refunded.

The question for this Board to decide is whether or not any interest can be deducted from the personal assessable income of the Taxpayer. The proviso to section 42(1) of the Inland Revenue Ordinance permits the deduction under personal assessment of ‘the amount of any interest payable on any money borrowed for the purposes of producing that part of the total income .

## INLAND REVENUE BOARD OF REVIEW DECISIONS

In the present case 'that part of the total income' is the property tax which was assessed on the property purchased by the Taxpayer and for which he used the loan of \$300,000 made by his mother-in-law. The Commissioner has not challenged and we have found as a fact that there was a loan of \$300,000 and that it was used for the purchase of the property in question. Accordingly the question for us to decide is narrowed down to the simple question of whether or not there was any interest paid or payable on the money borrowed.

From looking at all of the documentary evidence before us it is quite clear to us that the Taxpayer did not actually pay any money to his mother-in-law by way of interest and that there was no legally enforceable agreement between him and his mother-in-law under which interest could become payable. When we first began hearing this case it appeared as if it might have been a somewhat complex tax planning arrangement set up by the Taxpayer and his wife who were both qualified accountants. However as the case was explained to us it became quite clear that the matter had arisen as a result of a complex history and series of events which appear to have been allowed to take their natural course without anyone exercising positive control over them. It is quite clear that the Taxpayer should never had been asked to account to the Commissioner for interest tax in the first instance and it is from this unfortunate misunderstanding that the entire matter has then developed.

The onus of proof is upon the taxpayer in any tax case and clearly in this present appeal the Taxpayer has failed to produce adequate or any evidence of the payment or liability to pay interest to his mother-in-law. However as the Taxpayer was not able to appear before the Board we have approached this case in the most sympathetic manner which we can in favour of the Taxpayer. The evidence which we have before us comprises a letter written by the father-in-law of the Taxpayer which clearly states that no interest was paid or payable. Likewise we have a letter from the Taxpayer himself which states that the loan was not interest bearing. In support of his claim that interest was paid or payable a photocopy of a hand-written sheet of paper has been filed which nowhere refers to a loan of \$300,000 and does not state that interest had ever been paid. With due respect to the Taxpayer this hand-written statement is of no value to us in deciding this case and certainly is not sufficient to overcome the Taxpayer's own written statement to the Inland Revenue Department that the loan was a non-interest bearing transaction and was an internal family arrangement.

For the reasons given we dismiss this appeal and uphold the Deputy Commissioner's determination.