INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D102/03

Salaries Tax – whether expenditure incurred for professional indemnity insurance is deductible for salaries tax purposes – claim for a deduction for expense incurred for annual professional subscription allowed as concession – Departmental Interpretation and Practice Note No 9, paragraph 17 (revised September 2002) – the Board cannot alter the basis on which deduction was allowed – comments on the inherent unfairness in the contrasting rules governing salaries tax and profits tax deductions – sections 12(1)(a) and 16(1) of the Inland Revenue Ordinance ('IRO').

Panel: Andrew J Halkyard (chairman), David Li Ka Fai and Herbert Tsoi Hak Kong.

Date of hearing: 30 January 2004.
Date of decision: 25 February 2004.

This was an appeal by the taxpayer against a salaries tax assessment raised on her for the year of assessment 2001/02.

The taxpayer, a doctor employed by a university in Hong Kong (' the Employer'), claimed that she should be granted a deduction for her expense incurred in obtaining professional indemnity insurance for malpractice (' the Expense').

The Employer required the taxpayer to obtain the insurance:

(1) as a condition of permitting her to see patients at Hospital Authority hospitals for the purpose of her carrying out clinical research, which was a necessary part of the taxpayer' s employment, as she was a academic clinician of the university.

(2) because she also had a very limited private practice (for which she apparently received a small amount of fees).

The insurance policy therefore covered her activities not only as a clinical researcher but also as a doctor providing private professional services for a fee.

In her 2001/02 salaries tax assessment, the Commissioner allowed the taxpayer (in accordance with Departmental Interpretation and Practice Note No 9, paragraph 17; revised September 2002), by way of ' concession' , a deduction for her annual professional subscription as a Fellow of the Hong Kong Academy of Medicine.

In her notice of appeal the taxpayer impliedly objected to the method by which the deduction was granted. The taxpayer indicated that she should be entitled to this deduction as of right, rather than the more meanly termed ' concession' .

The facts appear sufficiently in the judgment.

Held:

1. The taxpayer had received the full benefit of the deduction for her annual professional subscription as a Fellow of the Hong Kong Academy of Medicine and, as a formal matter, this Board cannot alter the basis on which it was allowed. Its statutory duty is to confirm, reduce, increase or annul an assessment (section 68(8) of IRO).

2. The Expense could not be deducted for salaries tax purposes since it was not, in terms of section 12(1)(a) of the IRO, ' wholly and exclusively' incurred in the production of her assessable income liable to salaries tax.

3. At least part of the Expense should be deductible for profits tax purposes, since the taxpayer derived assessable profits from carrying out her profession as a private doctor.

General comments

4. The Board agreed with the taxpayer that the rules for salaries tax deduction, derived from ancient United Kingdom precedent, were enacted in a very different time to that existing in modern Hong Kong.

5. It goes without saying that the traditional case authorities for interpreting those rules – which go as far as to indicate that the opportunities for deduction ' come to nearly nothing at all' (see Lomax v Newton (1953) 34 TC 558 at 561 to 562) – are also of a venerable age.

6. That is not to say that ancient legislation and venerable authorities are not good law today. But the economic and social mores of present day Hong Kong – often imposed by law – have imposed a panoply of obligations upon salaries taxpayers that simply did not exist previously.

7. To the extent that these obligations involve the payment of money, it is rare for salaries taxpayers to be allowed any measure of tax relief. This is perhaps best

illustrated by reference to a very recent Board of Review decision D91/03 (unpublished) where a claim for deduction by an employed solicitor for mandatory professional indemnity insurance was disallowed on the ground that it was not incurred ' in the production of assessable income' but rather to put the solicitor in the position of earning assessable income.

8. The Board noted, in passing, that the same words ' in the production of assessable profits' are contained in section 16(1) of IRO, yet the result in a profits tax context (in the case where the solicitor was a sole practitioner or a partner of a law firm as distinct from an employed solicitor) would surely be very different.

9. The Board queried why an individual in the taxpayer' s position should be allowed (or denied) a deduction for a professional subscription and for mandatory insurance according to whether she is a profits taxpayer or a salaries taxpayer.

10. The United Kingdom has seen fit to allow a deduction for certain professional subscriptions to mitigate the harshness of the salaries tax deduction rules.

11. Hong Kong enacted the same rules based on United Kingdom precedent – so why should Hong Kong not follow suit and mitigate the same harshness? And why should the allowance of such a crucial matter (in the case of professional subscriptions) be left to the realm of ' concession' ?

12. In this particular case, it could be said that the taxpayer was being harshly dealt with from a taxation perspective *because* she decided to devote herself to her academic pursuits (as a salaries taxpayer) rather than as a private doctor (who as a profits taxpayer could presumably take advantage of deductions that frankly would leave the ordinary salaryman or salarywoman amazed).

13. On the other hand, it must be said that there may be good reasons for the salaries tax deduction rules to be both strict and rigorously applied (see Simpson v Tate [1925] 2 KB 214, per Rowlatt J). One may also say that it is good administration to ' hold the line' in this area, and indeed hold it very firmly.

14. The fact remains, however, that the line has not been firmly held in relation to professional subscriptions (see Department Interpretation and Practice Note No 9, paragraph 17, referred to above).

15. And when regard is also paid to the inherent unfairness in the contrasting rules governing salaries tax and profits tax deductions, the time may well be nigh to consider allowing employees some tax relief for expenditure – such as that illustrated by this appeal – which really are necessitated by the employment and the

changing nature of Hong Kong's legal, social and economic conditions.

Appeal dismissed.

Cases referred to:

Lomax v Newton (1953) 34 TC 558
D91/03 (unpublished)
Simpson v Tate [1952] 2 KB 214

Tsui Nin Mei for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal by the Taxpayer against a salaries tax assessment raised on her for the year of assessment 2001/02. The Taxpayer, a doctor employed by a university in Hong Kong ('the Employer'), claimed that she should be granted a deduction for her expense incurred in obtaining professional indemnity insurance for malpractice ('the Expense'). The Employer required the Taxpayer to obtain the insurance as a condition of permitting her to see patients at Hospital Authority hospitals for the purpose of her carrying out clinical research. It was a necessary part of the Taxpayer's employment, as a university academic, to undertake research. As an academic clinician, the Taxpayer's research involved clinical research.

2. In her 2001/02 salaries tax assessment the Commissioner allowed the Taxpayer (in accordance with Departmental Interpretation and Practice Note No 9, paragraph 17; revised September 2002), by way of 'concession', a deduction for her annual professional subscription as a Fellow of the Hong Kong Academy of Medicine. In her notice of appeal the Taxpayer impliedly objected to the method by which the deduction was granted. The Taxpayer indicated that she should be entitled to this deduction as of right, rather than the more meanly termed 'concession'.

The hearing before us

3. The Taxpayer did not press her case on whether her professional subscription should be allowed by right, rather than by way of concession. The Taxpayer was well aware that she had received the full benefit of the deduction and, as a formal matter, this Board cannot alter the basis on which it was allowed. Our statutory duty is to confirm, reduce, increase or annul an assessment (IRO, section 68(8)). We appreciate, however, that the Taxpayer's notice of appeal seeks to draw an analogy between her claim for deduction for both the professional subscription and the

Expense – namely, they should stand or fall on the same basis. We will comment generally upon this matter below.

4. When commencing her case, the Taxpayer gave sworn evidence. Very early, she admitted freely that the malpractice insurance policy was taken out not only for compliance with the strictures of the Employer (who would not allow her to see patients for clinical research without appropriate insurance), but also because she also had a very limited private practice (for which she apparently received a small amount of fees). In other words, the insurance policy covered her activities not only as a clinical researcher but also as a doctor providing private professional services for a fee.

5. After the Taxpayer gave this evidence, we explained to her our view that the Expense could not be deducted for salaries tax purposes since it was not, in terms of section 12(1)(a) of the IRO, ' wholly and exclusively' incurred in the production of her assessable income liable to salaries tax. We also explained our view that at least part of the Expense should be deductible for profits tax purposes, since she derived assessable profits from carrying out her profession as a private doctor. After reviewing with the Taxpayer the terms of section 12(1)(a), and commenting generally upon the very different rules for deductions allowable to profits taxpayers (see section 16(1)), we adjourned the hearing in order for the Taxpayer and the Commissioner' s representative to determine how they wished to proceed with this appeal.

6. Following the adjournment, the Taxpayer advised us that she was now prepared to withdraw her appeal. In light of her evidence referred to above, the Taxpayer has acted quickly, clearly and thoughtfully and we thank her for not unnecessarily prolonging the hearing. It is left for us to hereby formally dismiss the appeal and confirm the assessment in dispute.

General comments

7. We are pleased to formally record that, notwithstanding the Taxpayer' s withdrawal, she was clearly much more concerned with the principle and fairness of her claim for deduction than with its monetary value. The Taxpayer argued strongly that the salaries tax deduction rules, and the cases that show how strictly they are interpreted, were promulgated in very different times to today and are simply not appropriate to modern Hong Kong conditions. She also noted that in the United Kingdom annual subscriptions to professional bodies are allowed by statute (that is, by right) and not by concession (see ICTA 1988, section 201 permitting the deduction of subscriptions to certain professional bodies where payment of the subscription is a condition of employment). In light of these submissions, with which we sympathize, we have decided to make certain comments that the Administration may wish to consider.

8. We agree with the Taxpayer that the rules for salaries tax deduction, derived from ancient United Kingdom precedent, were enacted in a very different time to that existing in modern Hong Kong. It goes without saying that the traditional case authorities for interpreting those rules –

which go as far as to indicate that the opportunities for deduction ' come to nearly nothing at all' (see Lomax v Newton (1953) 34 TC 558 at 561 to 562) – are also of a venerable age. That is not to say that ancient legislation and venerable authorities are not good law today. But the economic and social mores of present day Hong Kong – often imposed by law – have imposed a panoply of obligations upon salaries taxpayers that simply did not exist previously. To the extent that these obligations involve the payment of money, it is rare for salaries taxpayers to be allowed any measure of tax relief. This is perhaps best illustrated by reference to a very recent Board of Review decision D91/03 (unpublished) where a claim for deduction by an employed solicitor for mandatory professional indemnity insurance was disallowed on the ground that it was not incurred 'in the production of assessable income' but rather to put the solicitor in the position of earning assessable income. We note, in passing, that the same words ' in the production of assessable profits' are contained in section 16(1), yet the result in a profits tax context (in the case where the solicitor was a sole practitioner or a partner of a law firm as distinct from an employed solicitor) would surely be very different.

9. We query why an individual in the Taxpayer' s position should be allowed (or denied) a deduction for a professional subscription and for mandatory insurance according to whether she is a profits taxpayer or a salaries taxpayer. As indicated above, the United Kingdom has seen fit to allow a deduction for certain professional subscriptions to mitigate the harshness of the salaries tax deduction rules. Hong Kong enacted the same rules based on United Kingdom precedent – so why should we not follow suit and mitigate the same harshness? And why should the allowance of such a crucial matter (in the case of professional subscriptions) be left to the realm of 'concession'?

10. Turning to the matter of malpractice insurance, the Taxpayer has informed us that in recent times insurance rates for malpractice and negligence are increasing dramatically. Our own experience confirms the accuracy of this statement. Should the allowance of a deduction (which in monetary terms can be quite significant) depend fortuitously on whether she did or did not have profits liable to profits tax, against which (as presumably in the Taxpayer' s case) at least part of the Expense can be allowed? As the Taxpayer asked poignantly – ' what would be the case if I didn' t earn any consultancy income?'

11. In the year under appeal, the Taxpayer did earn such income. Her income earning activity for this year (she mentioned that she only earned the sum of ' several hundred dollars') seemed not much more than an honorarium. It certainly did not indicate that the Taxpayer vigorously pursued a consultancy practice, although we state unequivocally that there is nothing before us to indicate that she was not properly liable to profits tax. In this particular case, it could be said that the Taxpayer was being harshly dealt with from a taxation perspective *because* she decided to devote herself to her academic pursuits (as a salaries taxpayer) rather than as a private doctor (who as a profits taxpayer could presumably take advantage of deductions that frankly would leave the ordinary salaryman or salarywoman amazed).

12. On the other hand, it must be said that there may be good reasons for the salaries tax deduction rules to be both strict and rigorously applied (see Simpson v Tate [1925] 2 KB 214, per Rowlatt J). One may also say that it is good administration to ' hold the line' in this area, and indeed hold it very firmly.

13. The fact remains, however, that the line has not been firmly held in relation to professional subscriptions (see Departmental Interpretation and Practice Note No 9, paragraph 17, referred to above). And when regard is also paid to the inherent unfairness in the contrasting rules governing salaries tax and profits tax deductions, the time may well be nigh to consider allowing employees some tax relief for expenditure – such as that illustrated by this appeal – which really are necessitated by the employment and the changing nature of Hong Kong' s legal, social and economic conditions.