

Case No. D29/06

Salaries tax – deductions – business investment and outgoings – estimates – sections 12(1)(a) and 68(4) of the Inland Revenue Ordinance

Panel: Anthony So Chun Kung (chairman), Sandy Fok Yue San and Gordon Kwong Che Keung.

Date of hearing: 20 March 2006.

Date of decision: 16 June 2006.

The taxpayer was employed as a sales and marketing manager of Company C. The taxpayer sought to claim deduction on investment he made in a business which he brought to Company C. He further claimed deduction on business trip expenses, telephone charges and transportation and entertainment expenses. As for the transportation and entertainment expenses, they were estimates only.

After close of the hearing, the taxpayer requested for time to organise and submit evidence in showing that he did incur transportation expenses.

Held:

1. The taxpayer confused and mistook his employment income with Company C as his business profit, as a result, he wrongfully claimed his investment in a business as deduction from his employment income.
2. The taxpayer claimed that the business trip was made to cultivate business for his employer Company C. If so, such business trip expenses were in fact business outgoings incurred for the business of his employer Company C. He should claim reimbursement of such business expenses from his employer. There is no justification whatsoever for the taxpayer to ask this Board to consider such business outgoings as employment expenses.
3. If the taxpayer used his own telephone and made calls for the purpose of his employer's business and incurred expenses, he should seek reimbursement over such telephone calls from his employer. He should not consider such telephone expense as his employment expense.

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4. The Board will follow the decision of the Board in D34/00 and reject the taxpayer's claim for deduction of mere estimates. Further the Board finds that the taxpayer's employment duties could be performed without incurring the travelling and entertainment expenses because otherwise his employer should and would reimburse him.
5. It is improper to allow the taxpayer to submit further evidence after close of the hearing, for otherwise this Board would be coaching the taxpayer, or gives such appearance.

Appeal dismissed.

Cases referred to:

D36/90, IRBRD, vol 5, 295

D35/04, IRBRD, vol 19, 295

D34/00, IRBRD, vol 15, 345

林哲民 訴 特佳機器廠有限公司及香港塑膠科技中心有限公司
(CACV122/2004)

Taxpayer in person.

Lau Wai Sum and Tsui Siu Fong for the Commissioner of Inland Revenue.

Decision:

The appeal

1. This is an appeal by Mr A ('the Taxpayer') against the determination of the Deputy Commissioner of Inland Revenue dated 30 November 2005 ('the Determination').
2. The issue in this appeal is whether the Taxpayer is entitled to claim deduction of certain expenses in respect of the years of assessment 2002/03 and 2003/04 ('the relevant years of assessment') which expenses were disallowed in the Determination. Those expenses are:

For the year of assessment 2002/03

- (a) Rent for the office of Taxpayer's business
from 20 July 2000 to 20 March 2001 HK\$269,100
(Bundle B1, pages 46, 48-57)

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(b)	Rate for the same office (Bundle B1, pages 58-59)	HK\$ 18,000
(c)	Management fee, phone, decoration, electricity and related outgoings of Taxpayer's business from 22 June 2000 to 5 February 2001 (Bundle B1, pages 46, 60-71, 121)	HK\$146,752
	(a) + (b) + (c)	HK\$433,852 ['Sum A1']
(d)	Three dishonoured cheques related to Taxpayer's business in 2000 - 2001 (Bundle B1, page 46, 86)	HK\$395,400 ['Sum A2']
	Sum A1 + Sum A2	HK\$829,252 ['Sum A']* =====

*[that is, Sum A as per paragraph 3(4) of the Determination at B1: page 113]

(e)	Expenses of Taxpayer's trip to Country B during 24 June 2002 to 29 June 2002 (Bundle B1, page 47, R1, pages 15-19)	HK\$ 23,300 ['Sum B1']
(f)	Telephone expenses for telephone bills dated from 21 June 2002 to 29 January 2003 (Bundle B1, pages 47, 72-85)	HK\$ 4,192 ['Sum B2']
	Sum B1 + Sum B2	HK\$27,492 ['Sum B']** =====

**[that is, Sum B as per paragraph 3(5) of the Determination at B1: page 113]

(g)	Estimated transportation and entertainment Expenses for year of assessment 2002/03 (Bundle B1, pages 87, 88)	HK\$ 43,000 ['Sum C1']
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For the year of assessment 2003/04

(h)	Estimated transportation and entertainment Expenses for year of assessment 2003/04 (Bundle B1, pages 87, 88)	HK\$ 63,000 ['Sum C2']
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Sum C1 + Sum C2

HK\$106,000 ['Sum C']***

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***[that is, Sum C as per paragraph 3(5) of the Determination at B1: page 113]

The evidence

3. The Taxpayer attended the hearing in person. He gave unsworn evidence. He relied on his previous letters to the Revenue as his appeal submission.

(1) In relation to his 2002/03 salaries tax assessment, the Taxpayer in his letter dated 15 November 2004 (B1: page 46) put forth the following contentions:

1. Employment contract with Company C

‘ I was association with [Mr D] [Company E] to set up the Company in Hong Kong called [Company F] in 2000 and I owned 15% share. The company started the small Electric Appliance business and we had to invest according to % share. I brought my customers to company and incharge of the Marketing function. [Mr D] does not invest according to the % share and he borrow money from myself in return his cheque and I paid some overdue payment. I kept chasing him for all debt and he runaway in 2002.

In 2002, all my customers were place an orders but we did not have enough capital to complete the orders. That why I were looking for company who could finished my orders. I entered into an agreement with [Company C] with 5% commission on P/L net profit. ...’

2. Expenses deduction

‘ ... The following previous investment [totaling \$829,252] which I paid for all my current business (HK\$60,000,000) but nobody paid me back. Without investing such money and no way I could get the business that why I should entitle to get tax return.’

<u>Name of Payment</u>	<u>Period covered /</u>	
	<u>Date</u>	<u>Amount(\$)</u>
(i) Rent paid to landlord by Company E as tenant for leasing the Property G [Note 1]	July 2000 to March 2001	269,100

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(ii) Rates and government rent for the Property G	July 2000 to March 2001	18,000
(iii) Miscellaneous expenses including decoration expenses and building management fee paid for the Property G	July 2000 to March 2001	146,752
(iv) 3 dishonoured cheques drawn respective by		
- Company F	31-12-2000	265,000
- Company H	04-01-2000	65,400
- Mr D	20-11-2001	65,000
		<u>395,400</u>
		<u>829,252</u>

Note 1:

The Property G means Address I, which was the business address of Company F. Company F was wound up by the Court on 3 July 2002.

3. Expenses from April 2002 to March 2003:

- (i) Business trip expenses of \$23,300, which comprised air-ticket fares of \$18,390 and hotel charges of \$4,910 in respect of the Taxpayer's trip to City J during the period from 24 to 29 June 2002.
- (ii) Telephone expenses of \$4,192.

- (2) In connection with his 2003/04 salaries tax assessment, the Taxpayer in his letter dated 10 January 2005 (B1: page 7) wrote:

' ... [A]fter checking with my accountant, I believe that there is the balance of business loss which I claimed on the letter of Nov 15, 2004 carrying forward to this assessment [as per Fact (6)].

The total loss:	HK\$829,252
Less Income of 2002/03:	HK\$487,430
<u>Less expense of 2002/03:</u>	<u>HK\$ 43,000 Approx</u>
The balance of loss carrying forward :	HK\$384,822

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Self Income of 2003/04:	HK\$654,296
Less the balance of loss:	HK\$384,822
Less Married person allowance	: 208,000
Less dependent parent allowance	: 30,000
Less Self education allowance	: 10,150
Less MPF	: 12,000
<u>Less Outgoing and other expense</u>	<u>: 63,000 (I disagree that you grant only 9,429)</u>
Net Chargeable income	: (HK\$53,676)'

- (3) In relation to Sum C1 for salaries tax assessment 2002/03 and Sum C2 for salaries tax assessment 2003/04, the Taxpayer in his letter dated 25 May 2005 (R1: page 24) wrote:

‘ For the traveling and entertainment, It involves 200 receipts and very difficult to record every transaction, I only claimed HK\$3,000 to \$4,000 a month and it is far from the actual expense. For example, I used to take a taxi to visit customers or go back our China factory and five times a week and the transport cost at least HK\$800 a week. Each transaction like from Office take first class train from Kowloon to Lowu for China Factory visit and return fare is HK\$128. Most of time pay by octopus and no receipts.’

- (4) The Taxpayer in his letter dated 8 August 2005 (B1: page 88) repeated his previous arguments in (1) and (2) above:

‘ First of all, I will not make any investment for no income and no business. In 2000, I was association with [Mr D] to set up the following company and he is majority shareholder and I am minority shareholder.

[Company F]

[Company E]

[Company K]

[Company H]

I found that these companies was received about HK\$60 millions customers payment and approx HK\$8- 10 million profit should be recorded on the audit report since 2000. [Mr D] was failed to protect minority shareholder interest by taken away all cash in bank and issue the dishonour cheque for material suppliers. Then he failed to fulfill all my customers’ orders. I have no choice, but to find another factory. [Company C] is finally entered an agreement with myself.

Until today he was not submitted any audited account statement for me.

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Secondly, All my current customers in [Company C] was asset of [Mr D] mine company. Without this, I will not have any income from [Company C]. For Example, [Company L] which is generated over HK\$100 million Sales for [Company C].

Thirdly, [Company C] never transfer its own customer to myself. That is, without my customers from my company, [Company C] will not pay me any commission. Not only that, in 2004, [Company C] was invite to Domo show in [Country M], after the show he asked me to return all walk-in customers' information. Of course, I should claim all expense as this is not generate any income for me.

Fourthly, Also [Company C] don't know how to manufacturer the Coffeemaker and I did transfer technique Know how, such as material and suppliers information for my company of [Company F] and [Company H].

Fifthly, [Company C] reimburse my expense based on the original receipt and approved by company. It is does not mean and it pay all expenses incurred to help in production of my income. For example, It is not my duties to go to [Company C] in [City N] and [City O], If I did not go there to watch my orders, my customers complained for late shipment. In fact, I shared air flight penalty. At the end, I loss at least HK\$200,000 assessable income. [Company C] never pay me back the transportation from Hong Kong to Lo Wu. Also, When my customers came to Hong kong for business trip, I used to pick them up with my car as [Company C] did not provide me with company car and never pay me back for this expense.

Finally, all my customers are located in oversea even they have office in Hong Kong, they all communicate with myself via my telephone [#xxxxxxx] and [xxxxxxx] after office hour. [Company C] did not pay this phone.

Thus, my account statement of business loss of Nov 15, 2004 with detailed receipt is truth copy and it related to my income of 2002/2003/2004/2005. Your statement that it was not essential or necessarily to incurred in the performance of duties of my employment with [Company C] does not make any sense....'

4. The Revenue produced an employment contract dated 12 March 2002 between the Taxpayer and his employer Company C (B1, pages 115-116). The contract was prepared by and under the letterhead of Messrs P:

‘ RE: APPLICATION FOR SALES AND MARKETING MANAGER

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Further to your application for the captioned post and subsequent interview at our office, we are pleased to offer to you on behalf of our client, [Company C] of ..., the position of the following terms and conditions:

Position: Director of Sales and Marketing – New Products Development Division.
Commencement date: 18th March 2002.
Office Hours: 8:30 AM to 5:30 PM with one hour for lunch on weekdays
Probationary Period: Six months from date of commencement of work.
Notice Period: Two weeks during probationary period;
Two months after probationary period.
Starting Salary: HK\$40,000 per month.
Remuneration Package after Probationary Period:
First year: Monthly salary of HK\$50,000 plus annual bonus payable at the discretion of [Company C] Chairman;
After first year: Monthly salary of HK\$40,000 plus performance bonus which is five percent (5%) of the audited net profit of New Products Development Division.

...’

5. The Revenue also produced a letter dated 11 March 2005 (R2: page 27) from the Taxpayer’s employer, Company C, which stated:

‘ ...

- (2) [The Taxpayer] is responsible for the sales and marketing of [Company C’s] new products coffee maker and fan heater which are launched since April 2003. [The Taxpayer] has to deal with customers, negotiate selling price and quantity of sales order and follow up the confirmed sales order.
- (3) Somehow [the Taxpayer] was required to entertain client such as having lunch or dinner with customer.
- (4) The traveling expenses incurred by [the Taxpayer] were miscellaneous, such as taxi fee, MTR fee, train fee to PRC.
- (5) ‘The entertainment/travelling expenses incurred by [the Taxpayer] in connection with his official duties were reimbursed by [Company C] on actual basis. [The Taxpayer] will gather the expenses receipts paid by him together as a lump sum and arrange cheque request to ask for reimbursement. It’s difficult to find the exact amount because of the amount is miscellaneous but the

total amount for each year ended 31 March 2003 and year ended 31 March 2004 would not exceed \$5000. Such reimbursement was reported as [Company C's] expenses (traveling expenses or marketing expenses) set off with company profit. If [the Taxpayer] has business trip to overseas, [Company C] will pay the ticket and accommodation. [The Taxpayer] does not need to pay any by himself.'

The law

6. Insofar as this appeal is concerned, the relevant sections of the Inland Revenue Ordinance ['IRO'] are sections 12(1)(a) and 68(4).

7. Section 12(1)(a) of the IRO governs the deduction of expenses for salaries tax purposes. The relevant part of section 12 reads as follows: (R2: page 1)

'(1) In ascertaining the net assessable income of a person for any year of assessment, there shall be deducted from the assessable income of that person –

(a) all outgoings and expenses, other than expenses of a domestic or private nature and capital expenditure, wholly, exclusively and necessarily incurred in the production of the assessable income;'

8. Section 68(4) of the IRO provides that: (R2: page 4)

'The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'

The applicable legal principles

9. The Board in D36/90, IRBRD, vol 5, 295, 299 said:

'It is generally accepted that the United Kingdom principles and test relating to the words "wholly, exclusively and necessarily in the performance of the said duties" (that is, the duties of the office or employment) are applicable to claims for deductions under section 12(1)(a). (See, for instance, D25/87.) In Lomax v Newton 34 TC 558 at 562, Vaisey J stated: "The words are stringent and exacting; compliance with each and every one of them is obligatory if the benefit of the rule is to be claimed successfully".'

7.1 Therefore, to succeed, the Taxpayer must prove: (1) that the expenses were incurred, (2) that they were incurred in the performance of the

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duties of a mamasan and (3) that they were wholly, exclusively and necessarily so incurred.

7.2 *As for the proof of expenses, the Taxpayer is faced with the task of proving that she incurred in the performance of her duties. ...*

7.3 *... It has been held that the words "in the performance of the duties" mean "in the course of the performance of the duties and not before or after the performance" (Rickets v Colquhoun [1926] AC1, 4 and 6; CIR v Humphrey). Furthermore, there is a distinction between expenses incurred in the course of producing income and those incurred for the purpose of producing income; while the former are deductible, latter are not (CIR v Burns 1 HKTC 1181 at 1189). ...'*

10. The Board in D35/04, IRBRD, vol 19, 295, paragraph 6 said:

'The Interpretation of section 12(1)(a) is notoriously rigid. As explained by Donovan LJ in Brown v Bullock 40 TC 1 at page 10, the test is whether the duties impose the expense "In the sense that... the duties cannot be performed without incurring the particular outlay".'

11. The Board in D34/00, IRBRD, vol 15, 345 refused to allow deduction of expenses which were mere estimates on the part of the Taxpayer. The Board maintained that the Taxpayer must first surmount the initial hurdle, which was to show that the expenses were actually incurred.

Analysis and findings

Sum A - HK\$829,252

12. The Taxpayer claimed that Sum A was incurred to generate the business connection which he took from Company F to Company C. He said that there would be no business connection if he had not incurred Sum A and without the business connection he would not have obtained the employment with Company C and earnings therefrom. The Taxpayer therefore argued that Sum A should be tax deductible from his earnings from Company C.

13. The Revenue argued that there was no evidence showing that the Taxpayer did incur Sum A, but even if he did, Sum A was his business investment in Company F and in nature a capital expenditure and as such was excluded under section 12(1)(a) of the Ordinance.

14. Moreover, the Taxpayer commenced his employment with Company C on 18 March 2002 while Sum A1 was in respect of outgoings for the period before March 2001, and Sum A2 on the other hand was cheques received by the Taxpayer before he joined Company C. Even if the

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Taxpayer did incur Sum A1 and Sum A2 as his expenses, they were incurred before the performance, and not in the course of the performance of his duties with Company C.

15. We agree with the Revenue's arguments.

16. Adopting the Taxpayer's own words, Sum A was his investment in a business including customers, products and know-how, which business he brought to Company C and which investment he considered as his 'business loss' (B1: pages 46, 87, 88). But Company C was his employer, not his business partner. It is true that for profit tax purposes, past business loss could be carried forward to set-off against future business profit. But past business loss could not become expenses deductible from assessable income for salary tax purposes. The Taxpayer confused and mistook his employment income with Company C as his business profit, as a result, he wrongfully claimed deduction from his employment income under Company C as if it was his business profit deductible against his previous business loss from Company F.

17. That also explains why the Taxpayer sought to deduct 'expenses' incurred in Company F, Company E and Company H in year 2000/01 against income he earned from Company C in year 2002/03 and 2003/04. He wrongfully equated his business involvement in Company F during 2000/01 with his employment with Company C during the relevant years of assessment, 2002/03 and 2003/04.

18. The Taxpayer's claim for deduction of Sum A (Sum A1 + Sum A2) must therefore fail.

Sum B1: business trip - HK\$23,300

19. The Taxpayer claimed that Sum B1 was business trip expenses comprising air fares of \$18,390 and hotel charges of \$4,910 incurred in cultivating business with customers in the year of assessment 2002/03 for Company C and accordingly should be tax deductible against his income from Company C.

20. The Revenue argued that according to his employer, Company C, the Taxpayer was not required to pay any transportation and accommodation expenses for his business trips and that it would reimburse traveling and entertainment expenses incurred by the Taxpayer in performance of his official duties (R1: page 27). The Revenue pointed out that, apart from bare assertions, the Taxpayer had not adduced any evidence to prove that he did pay Sum B and that they were wholly, exclusively and necessarily incurred in the performance of his duties with Company C. The Revenue questioned that if the expenses were necessarily incurred in discharging his official duties, why did the Taxpayer not ask for reimbursement from Company C. There was also no evidence to indicate that the Taxpayer could not have performed his duties without incurring those expenses. The Revenue said that Sum B failed to satisfy the 'necessarily' test.

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21. We agree with the Revenue's arguments.

22. The Taxpayer claimed that the business trip was made to cultivate business for his employer Company C. If so, such business trip expenses were in fact business outgoings incurred for the business of his employer Company C. He should claim reimbursement of such business expenses from his employer if in case he had really incurred such expenses, leaving his employer to deduct the same as business outgoings for its profit tax purpose. Being in nature business outgoings of his employer Company C, such business trip expenses cannot be said as expenses wholly exclusively and necessarily incurred by him in the performance of his employment. There is no room for the Taxpayer to elect not to claim for reimbursement from his employer. We must therefore reject the Taxpayer's bare assertion that his employer would not reimburse him such business trip expenses. There is no justification whatsoever for the Taxpayer to ask this Board to consider such business outgoings as employment expenses. The Taxpayer's claim for deduction of Sum B1 must fail.

Sum B2: telephone expenses - HK\$4,192

23. The Taxpayer produced telephone bills (B1: pages 72 – 75) in support of his claim for deduction of Sum B2 in the year of assessment 2002/03. The Taxpayer said that the telephone expenses were incurred in calling Country B customers and Mainland factories and that he made such calls in performance of his employment duties.

24. The Revenue pointed out that the telephone charges as shown in the telephone bills were mixed, charging the Taxpayer on various services like his residential line, roaming, tunnel fee, combined package including intra-network, bonus minutes, free airtime, IDD calls, etc. The bills amounts as claimed by the Taxpayer could not be said as 'wholly and exclusively' incurred in calls in performance of his employment duties. The Revenue further argued that there was no evidence showing that the Taxpayer could not contact the overseas customers without using his own telephones. The Revenue also argued that the Taxpayer had mentioned that all his overseas customers might have offices in Hong Kong (B1: page 89) and the Taxpayer could have used the telephone at his office to communicate instead of using his own telephones. It is of his volition to use his own telephones to contact with his customers and expenses so incurred should not be deductible.

25. We agree with the Revenue's arguments.

26. The Taxpayer was an employee performing his employment duties. He should use the telephone of his office to communicate. If he used his own telephone and made calls for the purpose of his employer's business and incurred expenses, he should seek reimbursement over such telephone calls from his employer. He should not consider such telephone expense as his employment expense. The Taxpayer's claim for deduction of Sum B2 fails.

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Sum C – \$43,000 for year 2002/03 and
\$63,000 for year 2003/04

27. The Taxpayer admitted that Sum C was mere estimates of transportation and entertainment expenses. The Taxpayer said that it was difficult to document relevant receipts and proofs and therefore he put up estimates.

28. The Revenue pointed out that Sum C was mere estimates on the part of the Taxpayer. The Revenue argued that the Taxpayer had admitted that it was not his duties to go to the China factory (B1: page 89), so even if he did go and incur expense, it was of his own volition and accordingly he was not entitled to claim deduction. The Revenue further pointed out that the Taxpayer's employer, Company C, had confirmed that all traveling and entertainment expenses incurred by the Taxpayer in performance of his official duties would be reimbursed to him on an actual basis (R1: page 27). Sum C as claimed would therefore fail the 'necessarily' test.

29. We agree with the Revenue's arguments.

30. We will follow the decision of the Board in D34/00, IRBRD, vol 15, 345 and reject Taxpayer's claim for deduction of mere estimates.

31. Further we find that the Taxpayer's employment duties could be performed without incurring the traveling and entertainment expenses because otherwise his employer should and would reimburse him. The fact that the Taxpayer has not sought reimbursement from his employer, Company C, does not mean that such traveling and entertainment expenses were not incurred for the business of his employer Company C and therefore a business outgoing of his employer, Company C. On the contrary, it makes it difficult for the Taxpayer to show that such traveling and entertainment expenses were not business outgoings of his employer Company C. Accordingly, the Taxpayer claim for deduction of Sum C as his employment expense fails.

Procedural matter

32. After close of the hearing, the Taxpayer requested for time to organize and submit evidence in showing that he did incur transportation expenses in Sum C.

33. We rejected the Taxpayer's request.

34. As confirmed by his employer, Company C, the Taxpayer could and indeed should first seek reimbursement of transportation expense incurred in performing his official duties from his employer, Company C; instead of asking this Board to consider such expense as his employment expense for tax deduction purpose.

35. After all, it is improper to allow the Taxpayer to submit further evidence after

close of the hearing, for otherwise this Board would be coaching the Taxpayer, or gives such appearance.

36. The Court of Appeal in 林哲民訴特佳機器廠有限公司及香港塑膠科技中心有限公司 (CACV122/2004) said

at paragraph 40(3) of the judgment:

‘The Judge is not the Plaintiff’s lawyers, who cannot assist the Plaintiff in finishing his burden of proof, or reminding him what proofs he should adduce before Court so as to patch up inadequacy of his evidence, because this would do injustice unto the Defendant.’

The original text in Chinese is as follows:

「法官不是原告人的代表律師，不可能協助原告人完成他的舉證責任，提點他應該向法庭呈交甚麼證據來彌補他證據上的不足，因為這會對被告人構成不公。」，and

at paragraph 59 of the judgment:

‘...all litigants must understand, irrespective of whether they are legally represented, the Court will try all cases according to litigation procedures, therefore, a litigant who has not properly prepared the evidence of his case must bear the consequences, and should have no blame against anybody.’

The original text in Chinese is as follows:

「...所有訴訟人士都必須明白，不論他們是否有律師代表，法庭一律會根據訴訟程序審理案件，所以若訴訟人士沒有為自己的案件做好證據方面的準備功夫，他必須承擔其後果，與人無尤。」

Conclusion

37. The Taxpayer has failed to discharge his onus of proof in showing that the expenses he claimed satisfy the tests as provided in section 12(1)(a) of the IRO. In the result, we dismiss the Taxpayer’s appeal and confirm the assessment as determined by the Deputy Commissioner.