INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D46/92

Salaries tax – study expenses – whether expenses deductible.

Panel: William Turnbull (chairman), Michael Choy Wah Ying and Charles Hui Chun Ping.

Dates of hearing: 22 and 27 October 1992.
Date of decision: 14 December 1992.

The taxpayer was employed by an accounting firm in Hong Kong as an assistant manager. He decided to pursue his career by going overseas to undergo a diploma study course of one year which entitled him to become a member of the Hong Kong Society of Accountants. The taxpayer submitted that the expenses of his attending the study course overseas should be deductible from his assessable income for salaries tax purposes.

Held:

Section 12(1)(a) of the Inland Revenue Ordinance requires that the outgoing or expense must be 'wholly, exclusively and necessarily' incurred and as a separate matter that it must be incurred 'in the production of the assessable income'. The Board held that the expenses claimed failed both tests. The studies of the taxpayer did not take place when he was on duty or performing the duties of an assistant manager in Hong Kong.

Appeal dismissed

Cases referred to:

FCT v Highfield 13 ATR 426
CIR v Humphrey [1970] 1 HKTC 451
CIR v Robert T Burns [1981] 1 HKTC 1181
CIR v SIN Chun-wah [1988] 2 HKTC 364
FCT v Wilkinson [1983] ATR 224
B/R 17/73, IRBRD, vol 1, 113
D89/89, IRBRD, vol 6, 328
D50/89, IRBRD, vol 4, 527
FCT v Hatchett [1971] 125 CLR 494
Lunney v CT [1957] 100 CLR 478

Pauline Lee for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

This is an appeal by a taxpayer against the refusal by the Deputy Commissioner to allow the Taxpayer to deduct from his salaries tax assessment certain study expenses. The facts are as follows:

1. The Taxpayer was employed by an accounting firm in Hong Kong as an assistant manager. The Taxpayer decided to pursue his career by going to Country X to undergo a diploma study course of one year. The diploma course was in financial management at a recognised university in Country X and was one of the requirements to enable the Taxpayer to be admitted as a member of the Society of Accountants in Country X. By becoming a member of the Society the Taxpayer would be entitled to become a member of the Hong Kong Society of Accountants.

2. Shortly after he was promoted to the post of assistant manager by his employer, the Taxpayer was granted no pay study leave to enable him to go to Country X at his own expense and pursue his studies by attending the diploma course in financial management.

3. The Taxpayer went to Country X in July 1989 and returned to Hong Kong in July 1990. During the period that he was away from Hong Kong he successfully completed the diploma study course. On his return to Hong Kong he resumed his full-time duties with his employer as an assistant manager. When he left on his no pay study leave his monthly salary was $15,000 per month. On resumption of his duties he was not promoted but his salary was increased to $19,000 per month. No reason or explanation was given regarding this increase. During the period that the Taxpayer was on no pay study leave he remained a member of his employer's staff provident fund but during his absence no contributions were made to the fund in respect of the Taxpayer. All fringe benefits to which he had been previously or was subsequently entitled were suspended during his no pay study leave period.

4. In his salaries tax return for the year of assessment 1989/90 the Taxpayer duly returned his taxable salary and emoluments which he had received from his employer prior to going on no pay study leave. His total assessable income for the year was $34,758. He claimed as an expenses the expenses which he had incurred in studying for the diploma in financial management in Country X totalling $52,163 and comprising the tuition fee and a semester compulsory charge. The Taxpayer did not claim any of the other expenses which he may have incurred in relation to his going to Country X and living in Country X nor any other out of pocket expenses that he may have had in relation to the diploma course.

5. The assessor rejected the claim by the Taxpayer to deduct the study expenses but as the total assessable income of the Taxpayer was only $34,758 and he was entitled to a personal allowance of $39,000 the assessment for the year of assessment 1989/90 which was raised on the Taxpayer was a nil assessment.

6. The Taxpayer objected to this assessment on the ground that there was 'a strong perceived connection' between the study leave expense and his assessable income and submitted that the expense of $52,163 should be allowed as an expense.

7. The case was referred to the Deputy Commissioner following the objection of the Taxpayer. By his determination the Deputy Commissioner confirmed the assessment and rejected the argument put forward by the Taxpayer.

8. By letter dated 9 July 1992 the Taxpayer duly appeal to this Board of Review.

At the hearing of the appeal the Taxpayer appeared in person and elected not to give evidence. He submitted that the expense of $52,163 which he had incurred in attending the diploma course in Country X should be a deductible expense in the year of assessment 1989/90. He said that it was not material whether or not he had received any income during the period when he had incurred the expense and cited to the Board the case of FCT v Highfield 13 ATR 426. He said that that case was authority to say that expenses incurred in one year could be offset against subsequent income.

The Taxpayer went on to cite the case of CIR v Humphrey [1970] 1 HKTC 451 and submitted that this was authority that the Highfield case should apply to Hong Kong. He drew our attention to the words of Blair-Kerr, J at page 467 where he said, 'it would appear, however, that the difference in phraseology is immaterial so far as this appeal is confirmed.'

With due respect to the Taxpayer whatever the words of Blair-Kerr, J may have meant the most significant words are 'so far as this appeal is concerned'. The Humphrey case related to whether travelling expenses were deductible and has limited relevance to the case before us.

The Taxpayer submitted that the study expenses were not domestic or private and were wholly, exclusively and necessarily incurred by him. He pointed out that he was not claiming any of his personal expenses. The Taxpayer then submitted that there was an 'on duty' test. He said that on the authority of CIR v Robert T Burns [1981] 1 HKTC 1181 there was no distinction between the 'on duty test' and a 'perceived connection test'. He said that there was a strong 'perceived connection' between his study leave expense and his assessable income and accordingly the expense should be deductible.

The Taxpayer then went on to distinguish the cases of CIR v Robert T Burns and CIR v SIN Chun-wah [1988] 2 HKTC 364 on their facts. He said that the expenses which he had incurred were to maintain or increase his learning, knowledge, experience and

ability in his profession or calling. He again referred us to the case of FCT v Highfield and to the case of FCT v Wilkinson [1983] ATR 224 the facts of which he said were very similar to his own case.

The Taxpayer then drew attention to the fact that after he had returned to Hong Kong and resumed his duties as assistant manager his salary had been increased from $15,000 to $19,000. He submitted that the $4,000 per month difference was not because he had been promoted because he held the same post as assistant manager. He said that he had been promoted to the post of assistant manager shortly before he went on his study leave. He said that this meant that his no pay study leave had resulted in the production of assessable income in a subsequent year and that the expenses which he had incurred should be deductible.

The Taxpayer went on to refer us to B/R 17/73, IRBRD, vol 1, 113 and said that this case was different from his own because the lecturer was not a professional and was an academic. He said that it was different to his own case because there was no perceived connection and the Taxpayer in B/R 17/73 was not on duty.

He then referred to D89/89, IRBRD, vol 6, 328 and again sought to distinguish the case in like manner.

The Taxpayer then referred to D50/89, IRBRD, vol 4, 527 where he again said that a university lecturer was not a professional person and that the expense to update the knowledge of a non-professional person did not automatically lead to an increase in his salary.

The Taxpayer then referred to FCT v Hatchett [1971] 125 CLR 494. He said that the expenses in obtaining a teacher's higher certificate were deductible because there was a perceived connection.

The representative for the Commissioner confirmed for the sake of clarification that it was agreed that the Taxpayer had remained in the continuous employment of the employer and that when the Taxpayer had taken no pay study leave the employment did not terminate. This clarification was because there had previously been some confusion relating to this. The employer had notified the Commissioner that the employment of the Taxpayer had been terminated and had subsequently withdrawn this notification.

The representative for the Commissioner pointed out that the diploma course was self-sponsored by the Taxpayer and was not a requirement of the employer. During the period that the Taxpayer was on study leave he was not entitled to any remuneration or any fringe benefits from the employer. Though his employment continued he did not receive any emoluments.

The representative for the Commissioner submitted that two questions had to be answered. The first was whether the expense were incurred in the production of the

assessable income. The second question was whether the expenses were wholly, exclusively and necessarily so incurred.

The representative for the Commissioner submitted that to answer the first question it was necessary to apply the 'on duty test'. She cited CIR v Humphrey. She then said that D89/89 had used the 'on duty test' on the authority of CIR v Humphrey. She then referred us to D50/89 where she said the Board had again used the 'on duty test'. She said that on the authority of these cases the Taxpayer was not on duty as an assistant manager when he was studying in Country X because there was no evidence that the duties of an assistant manager required him to take the diploma course.

The representative for the Commissioner then referred to the 'wholly, exclusively and necessarily' test. She said that the expenses had not been necessarily incurred because there was no evidence to say that the employer required the Taxpayer to take the diploma course which had been taken by him voluntarily of his own volition. She said that the expenses were not necessarily incurred because they were not imposed by the Taxpayer's duties. She said they were not essential to the performance of his duties.

In relation to the 'perceived connection test' the representative for the Commissioner referred to FCT v Hatchett and CIR v Robert T Burns. She said that the expenses in the present case did not meet the 'perceived connection test' because the diploma course offered in Country X did not entitle the Taxpayer to be paid more money for doing the same job as an assistant manager. She pointed out that there was no evidence before the Board as to why the income of the Taxpayer had been increased when he returned from Country X and reminded the Board that at that time there had been substantial salary increases in Hong Kong. There were staff shortages, and there could be many reasons unknown to the Board why the salary of the Taxpayer had been increased. She finally reminded the Board that even if a 'perceived connection test' had been met it was still necessary to meet the 'wholly, exclusively and necessarily' test.

It is perhaps surprising that cases of this nature continue to come before the Board of Review. The courts have repeatedly held that the expenses which an employee can deduct from his taxable emoluments subject to salaries tax are very limited. The governing words in section 12(1)(a) of the Inland Revenue Ordinance are that for any outgoing or expense to be deductible it must be, (1) 'wholly, exclusively and necessarily', incurred and, (2) incurred 'in the production of the assessable income'. On the facts before us it is quite clear that the expense claimed was not necessarily incurred and furthermore that the expense claimed was not incurred in the production of the assessable income. Accordingly the claim by the Taxpayer fails on both grounds.

There was nothing necessary about what the Taxpayer did. The Taxpayer wished to pursue his career by becoming a qualified accountant and member of the Hong Kong Society of Accountants. To achieve this he decided that he would go to Country X to pursue his studies and thereby become a member of the Society of Accountants in Country X. This he proceeded to do and according to what the Taxpayer told us in the course of his submission he was successful in joining the Society of Accountants in Country X and

subsequently became a member of the Hong Kong Society of Accountants. However this was some time after he had returned to Hong Kong and resumed his duties as an assistant manager at the salary of $19,000 per month. The Taxpayer's employer did not require him to go to Country X to study. The duties of being an assistant manager did not require the Taxpayer to go to Country X to study. Before he went to Country X he was promoted to the post of assistant manager and after his return to Hong Kong he resumed his duties as such assistant manager. It was not necessary for the Taxpayer to undertake the diploma course in Country X other than his desire to further his personal ambition to be a member of the two professional bodies in County X and Hong Kong.

Much of what we have said relating to 'necessary' also applies to deciding whether or not the expense was incurred in the production of the assessable income. The income about which we are talking is the income of the Taxpayer as an employee holding the post of assistant manger in an accounting firm. The Taxpayer repeatedly referred to the case of FCT v Highfield and repeatedly said that the expenses were deductible in his case because he was a professional person who was increasing or updating his knowledge. The Taxpayer likewise spent considerable time submitting that the words 'perceived connection' were the same as 'on duty' and that there was a clear 'perceived connection' between his studies and his subsequent taxable emoluments.

The Hong Kong cases start with the leading case of CIR v Humphrey. This was a 1970 Court of Appeal decision. The leading judgment was by Blair-Kerr, J. The facts were simple. A Government employee was required to work in the New Territories. He was provided with Government quarters in Kowloon. Under his terms of employment he was entitled to claim partial reimbursement of expenses incurred by him in using his car to go from his home to his office, that is from his quarters in Kowloon to his place of work at Tai Po. The assessor included in his assessable income the reimbursement which he received from his employer for travelling from his home to his place of work and refused to deduct the amount as an expense. The matter was ultimately appealed to the Court of Appeal.

Blair-Kerr, J at page 465 said that it was first necessary to decide whether or not the partial reimbursement of travelling expenses formed part of the taxable income of the respondent within the meaning of sections 8(1) and 9(1) of the Inland Revenue Ordinance. This part of the Court of Appeal decision has no reference to the case before us.

At page 466 Blair-Kerr, J refers to the third question before him which he summarised as follows:

> 'The point for decision in respect of the third question is whether, even if the $559.30 was income, (but quite irrespective of whether or not the sum had been paid to the respondent) the expenses incurred by him in using his car in home-to-office journeys were outgoings and expenses wholly, exclusively and necessarily incurred by him in the production of his assessable income.'

It is this third question which is relevant to us. After setting out the respective arguments for the two parties, Blair-Kerr, J at page 482 finds that the respondent was not on duty when he was travelling to and from the office. He decided that there was nothing different between the case of the respondent and many other cases where the courts had stated that the expenses of a person in travelling to and from his place of work are not tax deductible. This was supported by Mills-Owens, J who at page 487 says, 'in the case of expenses incurred by an employee using his own car in travelling to and from work, the dividing line must be whether or not he is on duty in so doing. Clearly, in my view, the respondent was not on duty.'

The ratio decidendi of CIR v Humphrey is that to be allowable an expense must be incurred by a person when he is on duty and that when travelling to and from work a person is not on duty.

The next Hong Kong case is B/R 17/73. This was a case where the Taxpayer was employed by the University of Hong Kong. The Taxpayer was granted study leave to pursue certain studies in the United Kingdom. The Taxpayer claimed as deductible expenses the cost of his travelling between his place of residence in England to London for a period of two weeks and also claimed the cost of his fare from London to Hong Kong. The question which the Board of Review was asked to decide was whether or not these expenses had been incurred wholly, exclusively and necessarily in the production of the assessable income of the Taxpayer.

The Board of Review made reference to CIR v Humphrey as authority for the proposition that English taxation cases could be relied upon in Hong Kong because the English word 'in the performance of the duties of the office or employment' had a similar meaning to the Hong Kong words 'in the production of such assessable income'. Before travelling expenses can be deducted they must be incurred in the performance of the duties of the Taxpayer's office or employment.

The Board of Review dismissed the appeal of the Taxpayer because when performing studies in the United Kingdom the Taxpayer was not on duty. The Board found as a fact that the Taxpayer only had one place to perform his duty which was Hong Kong. The Board further found as a fact that the Taxpayer undertook his study leave entirely voluntarily and that he was not required by his employer to undertake such studies.

The next Hong Kong case in order of time is CIR v Robert T Burns. That was a case in which a trainer of horses incurred legal expenses in successfully challenging a Jockey Club disqualification. The Burns case is a Court of Appeal decision and the judgment was delivered by Huggins, J A. The Court of Appeal was required to interprete and apply section 12(1)(a) of the Inland Revenue Ordinance. This case is of considerable importance to us because it introduces into Hong Kong the concept of a 'perceived connection test'. Huggins, J A at page 1189 refers to FCT v Hatchett. He summarises that case as follows:

> 'There the taxpayer was a teacher. With a view to advancing himself in his profession he took two steps, (1) he submitted some theses for the purpose of gaining a Teacher's Higher Certificate and (2) he took a course at a university. In connection with each of these steps he incurred expenses and he sought to deduct some or all of those expenses from his assessable income for income tax. It was held by the High Court of Australia that the expenses of submitting the theses were deductible, because the grant of the Teacher's Higher Certificate automatically entitled him forthwith to be paid more for doing the same type of work without any change in his grade and the outgoings were thus incurred in producing the assessable income. On the other hand, the expenses of the university course were not deductible because, although the additional qualification which the Taxpayer obtained might make him a better teacher and in the course of time might lead to promotion, there was no "perceived connection" between the outgoing and the assessable income.'

Huggins, J A then refers to the case of Lunney v CT [1957] 100 CLR 478 as the authority for a distinction between an expense incurred in gaining income and one incurred necessarily for the purposes of gaining it. Lunney case referred to the expenses of travelling to and from a place of work. Huggins, J A then points out that McTiernan, J in Lunney case was prepared to recognise a looser 'perceived connection' between the expenditure and the assessable income. McTiernan, J said, 'I cannot see the difference in principle between an expense incurred in gaining income and one incurred necessarily for the purpose of gaining it.' Huggins, J A then negatives this point of view by saying 'that is an approach which has much to be said for it, but I think the weight of authority is against it.' It is in the light of these words that we must read and understand what Huggins, J A said at page 1190 namely, 'in practice there is probably no real distinction between this "on duty test" and the "perceived connection test" of the Australian courts.' What Huggins, J A is saying is that the Australian perceived connection test is just as strict and has the same meaning as the on duty test and is not to be given a looser or wider meaning. Huggins, JA then proceeds to find in favour of the Commissioner and says the following:

> 'Although some may regard this as an artificial distinction, there is weighty authority for drawing it and I think that authority ought to be followed.'

The next Hong Kong case is CIR v SIN Chun-wah. The facts of that case have little relevance to the present case. It related to an employee who paid money in lieu of notice to terminate his employment. This case was brought by the Commissioner for the purpose of clarifying the application of section 12(1)(a). It is accordingly an important case to us. The learned judge reviewed the cases set out above and clearly upholds the concept that even though expenses are incurred in order to place a person in a position in which he is able to earn part of the assessable income, they are not incurred in the production of it. At page 371, Nazareth, J says:

> 'Needless to say, I consider the English and Australian authorities I have referred to of much assistance in constructing the Hong Kong criteria in section

12(1)(a). It is clear from Burns and Humphreys that that was also the view of the Full Court and the Court of Appeals.'

There were two Board of Review decisions in 1989, namely, D50/89 and D89/89. In the first of these two cases the Taxpayer was employed by a university in Hong Kong. He went to the United Kingdom for the purpose of studying for a master's degree course and was granted special leave for approximately one year to undertake this course. That Board of Review found that there was a 'perceived connection' between the studies in the United Kingdom and the 'activities regularly carried out by the Taxpayer in his post at the university' but went on to find that the expenses were not wholly, exclusively and necessarily incurred. It is clear that the Board of Review in D50/89 would have dismissed the appeal now before us.

D89/89 again relates to an employee of a university who in this case attended an overseas conference. The Board limited itself to the application of the word 'necessarily' and found that there was nothing necessary in the expenditure incurred. Again it was clear that if the case now before us had come before that Board of Review they would have dismissed the claim by the Taxpayer.

Having reviewed the Hong Kong cases which by implication has reviewed the overseas cases we are able to state quite clearly and simply that section 12(1)(a) of the Inland Revenue Ordinance requires that the outgoing or expense must be 'wholly, exclusively and necessarily' incurred and as a separate matter that it must be incurred 'in the production of the assessable income'. In relation to this second test the expense must be incurred while the Taxpayer is on duty and in the performance of his duties. There must be a 'perceived connection' between the expense and the duties and the 'perceived connection' must be the same as or have no wider meaning than 'on duty and in the course of the duties'.

Applying this to the present case it is quite clear that the appeal by the Taxpayer fails on this second ground as well as on the first. The studies of the Taxpayer did not take place when he was on duty or performing the duties of an assistant manager in Hong Kong. The work that he performed in Country X in undertaking the diploma course was something which he did of his own volition so that he would be better qualified and would become in due course a member of the Hong Kong Society of Accountants. His employment was an assistant manager of an accounting firm in Hong Kong. His studies were not part of his duties and accordingly were not incurred by him 'in the production of the assessable income'.

The mistake which the Taxpayer has made in bringing this appeal is that he has tried to give the words 'perceived connection' a much wider meaning than the words 'on duty'. It seems to us that the words 'perceived connection' are capable of many different meanings both wider and narrower. They are non-statutory words and have no statutory meaning. We accept that they have crept into the language of the courts in Country X and perhaps this is unfortunate because they are more ambiguous than the simple words 'on duty'. Huggins, J A in the Burns case says that in practice there is probably no real distinction between the 'on duty test' and the 'perceived connection test' but then makes it

quite clear and positive that the 'perceived connection test' is not to be given a looser interpretation. The Taxpayer in his submissions to us failed to appreciate this vital and important point.

In the course of hearing this appeal we queried whether or not the expense claimed could in any event have been deducted or allowed in the year in question. In view of the decision which we have reached it is not necessary for us to decide this point. It seems to us that the expense claimed could not relate to the income which the Taxpayer earned prior to his going to Country X. The Taxpayer submitted that an expense for salaries tax purposes can be carried forward and can be attributed to future income and in support of this submission cited the Australian case of FCT v Highfield, which as we understand it related to profits tax rather than salaries tax. As the matter does not come for decision by us we take the point no further. It does appear to us however that there could be complications which we leave for future Boards to consider if and when they arise.

For the reasons given we dismiss this appeal and confirm the decision of the Deputy Commissioner.