INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D59/91

Salaries tax – claim to deduct commission payments – onus of proof – whether commission payments wholly, exclusively, and necessarily incurred in the production of the assessable income – section 12(1)(a) of the Inland Revenue Ordinance.

Panel: Robert Wei QC (chairman), William Chan Wai Leung and Cheung Wai Hing.

Date of hearing: 12 November 1991.
Date of decision: 20 December 1991.

The taxpayer was employed by a company and received a small salary and a large sum by way of commission. The taxpayer claimed that he had paid out of the commission which he had received, commission payments to two companies relating to business with the People's Republic of China. The Commissioner did not accept that all of the alleged commission payment expenses had been made and also was of the opinion that the commission payments were not expenses incurred by the taxpayer wholly, exclusively, and necessarily in the production of the assessable income. The taxpayer did not attend the hearing of the appeal because he had emigrated to Canada.

Held:

The taxpayer had failed to prove his case. The Board was not satisfied that the taxpayer had paid the commission payments which were challenged by the Commissioner and the Board was of the opinion that none of the commission payments had been wholly, exclusively, and necessarily, incurred in the production of the assessable income.

Appeal dismissed.

Cases referred to:

CIR v Humphrey 1 HKTC 451
Ricketts v Colquhoun 10 TC 118
Lomax v Newton 34 TC 558

Chiu Kwok Kit for the Commissioner of Inland Revenue.
Taxpayer in absentee.

Decision:

1. The Taxpayer is appealing against the determination dated 31 January 1991 of the Deputy Commissioner of Inland Revenue increasing the salaries tax assessment raised on him for the year of assessment 1987/88 from a net assessable income of $1,097,189 with tax payable thereon of $181,085 to a net assessable income of $1,447,489 with tax payable thereon of $238,835.

2. The Taxpayer claims that during the year, he made certain payments of commission which should be deducted from his assessable income.

3. During the year the Taxpayer served as a director of X Limited (X Ltd). The employer's return for the year reported the Taxpayer's income as:

	$
Salary/Wages	60,000
Commission	1,387,339.35
	1,447,339.35

4. At a director meeting in early 1987, it was resolved that the Taxpayer be appointed the managing director of X Ltd. His remuneration consisted of an annual salary of $65,000 and commission at five percent of the sales of X Ltd.

5. In his salaries tax return for the year, the Taxpayer claimed against his income of $1,447,489 a deduction for commission paid of $350,000.

6. On 28 December 1988 the assessor raised on the Taxpayer the following salaries tax for the year of assessment 1987/88:

	$
Principal Income	1,447,489
Less: Outgoings	350,000
Net Chargeable Income	1,097,489
Tax thereon	$181,085

7. On 25 January 1989 the Taxpayer by notice in writing to the Commissioner of Inland Revenue objected to that assessment on the ground that he had paid out $1,200,000 commission as follows:

$

Y Ltd	600,000
S Corp	600,000
	1,200,000

8. Under cover of his letter dated 18 March 1989, the Taxpayer provided the Commissioner of Inland Revenue with copy receipts of the alleged commission payments:

(a) Y Ltd received:		$
(i)	5 January 1988	50,000
(ii)	11 February 1988	200,000
(iii)	3 March 1988	250,000
(iv)	23 March 1988	100,000
		600,000

(b) S Corp received:		$
(i)	20 September 1987	200,000
(ii)	4 October 1987	150,000
(iii)	15 December 1987	250,000
		600,000

9. The Taxpayer has described the nature of the services of Y Ltd and S Corp in these terms:

> ' [Y Ltd] was employed as agent to find the sources of goods imported to China, and S Corp was employed to import goods to our client and help to transfer money to Hong Kong.'

10. The Taxpayer has provided the Inland Revenue Department with certain bank statements to substantiate payments to Y Ltd. He did not provide any documents regarding the alleged payments to S Corp, as the payments, all made in China, were illegal and that therefore no documents were used.

11. In his letters to the Clerk to the Board of Review, the Taxpayer repeatedly stated that Y Ltd, not the Taxpayer, should pay tax on the commission payments made to it by him.

12. The Taxpayer gave his notice of appeal late and was absent at the hearing of this appeal as he had emigrated to Canada. There being no objection on the part of Mr Chiu, the representative of the Deputy Commissioner of Inland Revenue, we decided to grant the necessary extension of time to validate the notice of appeal (as constituted by the Taxpayer's letter dated 10 May 1991 to the Clerk to the Board of Review) and to hear the appeal in the absence of the Taxpayer.

13. The matter of allowable deductions is governed by section 12(1)(a) of the Inland Revenue Ordinance which reads:

> ' 12(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 … wholly, exclusively and necessarily incurred in the production of the assessable income …'

The key words are 'wholly, exclusively and necessarily ... in the production of the assessable income'. The comparable words in the corresponding English provision are 'wholly, exclusively and necessarily in the performance of the said duties (that is, the duties of the office or employment of profit)'. Case law in English has been followed in Hong Kong in interpreting the comparable words of section 12(1)(a), the approach being that there is no substantial difference in effect between the words 'in the production of the assessable income' and the words 'in the performance of the duties of the office or employment of profit' (see CIR v Humphrey 1 HKTC 451 at 466-467). The interpretation is strict and narrow: in Ricketts v Colquhoun 10 TC 118, Lord Blanesburgh said, '... the language of the rule points to the expenses with which it is concerned as being confined to those which each and every occupant of the particular office is necessarily obliged to incur in the performance of its duties, to expenses imposed upon each holder ex-necessitate of his office and to such expenses only.'; in Lomax v Newton 34 TC 558, Vaisey J said, 'An expenditure may be 'necessary' for the holder of an office without being necessary to him in the performance of the duties of that office; it may be necessary in the performance of those duties without being exclusively referrable to those duties; it may perhaps be both necessarily and exclusively, but still not wholly so referable. The words are indeed stringent and exacting; compliance with each and every one of them is obligatory if the benefit of the rule is to be claimed successfully. They are, to my mind, deceptive words in the sense that when examined they are found to come to nearly nothing at all.'

14. To succeed in this appeal, the Taxpayer must prove: (1) that the total sum of $1,200,000 was incurred; (2) that it was incurred in the production of the assessable income; and (3) that it was wholly, exclusively and necessarily so incurred. As for the first limb, the Taxpayer has produced some evidence of the source of the funds for the payments totalling $600,000 made to Y Ltd; furthermore, it is not part of Mr Chiu's submission that the Taxpayer has failed to prove those payments; we therefore find that the total sum of $600,000 was incurred. As regards the other sum of $600,000 allegedly paid to S Corp in China, the Taxpayer stated in his letter dated 25 June 1991 to the Clerk to the Board of Review that 'all exchanges of RMB were underground and illegal in China' and that 'the payment of commissions was also illegal in China'; we find it difficult to understand: (1) how it was that he was able to obtain formal receipts of commission from S Corp and (2) why he has not produced evidence to prove his Hong Kong source of funds used to fund the alleged payments to S Corp; we therefore accept Mr Chiu's submission that the Taxpayer has failed to prove the alleged payments to S Corp. Moving on to the second and third limbs, we are of the view that here the Taxpayer has failed completely. It is only necessary to consider the Y Ltd payments, although our reasons would have applied equally to the

alleged S Corp payments had we found that they were made. There is no evidence to show any connection between any of the payments and the Taxpayer's income which consisted of a salary of $60,000 and a total commission of $1,387,489. We do not know how that sum is arrived at; even assuming that it was calculated as a percentage of the sales, that does not carry the matter further because we are not provided with any particulars of the sales. The Taxpayer has not traced any of the commission payments to any of the sales or to any of the commission paid by X Ltd to him. Thus, there is no substratum of facts on which to consider the application of the words 'in the production of the assessable income' or the words 'wholly, exclusively and necessarily'.

15. The Taxpayer having failed to prove that the sum of $1,200,000 or any part thereof is an allowable deduction, this appeal is dismissed and the assessment as revised by the Deputy Commissioner of Inland Revenue is hereby confirmed.