

Case No. BR 9/78*Board of Review:*

L. J. D'Almada Remedios, *Chairman*, D. A. Graham, B. S. McElney,
and E. J. S. Tsu *Members*.

7th October 1978.

Salaries tax—employee terminating contract of service—payment of one month's salary in lieu of notice—acceptance of employment elsewhere—whether payment an allowable deduction under section 12(1)(a) of the Inland Revenue Ordinance.

The appellant, formerly employed by the Hong Kong Government under contract terms, terminated his services with the Government and paid to Government one month's salary in lieu of the three months' notice as stipulated. The appellant took up another employment and in the assessment of his income for salaries tax claimed that the payment of the one month's salary to Government in lieu of notice was an allowable deduction under section 12(1)(a) of the Inland Revenue Ordinance. He contended that the sum so paid was an outgoing expense wholly, exclusively and necessarily incurred in the production of his assessable income. The Commissioner rejected the claim. On appeal.

Decision: Appeal disallowed. Assessment confirmed.

Taxpayer in person.

Osman Ghafur for the Commissioner of Inland Revenue.

Reasons:

1. The Appellant was formerly employed as an officer with the Hong Kong Government. His service was for a fixed period and his contract provided that in the event of his wishing to terminate his service before the expiry of his contract, he would have to either give 3 months' notice of such intention or pay 1 month's salary in lieu of notice. The Appellant elected to terminate his service with the Government without giving the requisite 3 months' notice. Accordingly, he paid 1 month's salary in lieu of notice and he thereupon accepted employment elsewhere. The sum the Appellant paid to the Government in lieu of notice was \$6,600.00 and he claims that this sum is an outgoing or expense wholly, exclusively and necessarily incurred in the production of assessable income and is an allowable deduction under section 12(1)(a) of the Inland Revenue Ordinance. His claim was disallowed by the Commissioner and he now appeals to this Board.

2. The relevant section on which the Appellant relies reads as follows:—

“12. (1) In ascertaining the net chargeable income in respect of which a person is chargeable to tax under this Part 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.”.

3. In giving his reasons for disallowing the objection the Commissioner states, *inter alia*, that the words “in the production of income” is a phrase that has been held to mean “in the performance of the duties of the employment” and as the Appellant did not pay the \$6,600.00 to the Government “in the performance of his duties with the Government” the benefit of the section on which the Appellant relies is not available to him. The Appellant criticizes the validity of the Commissioner’s reasoning since the section makes no reference to “performance of duties” but to the “production of assessable income”. Although in most cases it may well be that the production of assessable income would involve the performance of one’s duties or allied to it this may not necessarily be so in all cases. We agree, therefore, with the Appellant, that the test of deductibility must be considered having regard to what is stated in the section.

4. The Appellant’s case is that by contract he had to pay the Government one month’s salary in lieu of notice and in so doing he was able to accept employment with another employer. In the circumstances, he contends this was an expense or outgoing in the production of assessable income.

5. This argument, though attractively put for its simplicity, does not appear to us to meet the conditions that must exist for an outgoing or expense to be deductible for salaries tax purposes.

6. As stated by the Commissioner in his reasons, the expense was not incurred for the purpose of producing assessable income from the Government. On the contrary, the payment was to finalise severance of his relationship with his former employer. The Appellant is, therefore, left with the onus of showing that it was incurred to gain assessable income from the new employer. If so, the Appellant must show that it was “wholly, exclusively and necessarily” incurred for that purpose. As the Appellant had terminated his services with the Government, failure to pay the \$6,600.00 to his former employer would not preclude him from taking up employment with his new employer. It would merely give to the Government a right of action for payment or damages. This being so, the payment by the Appellant was not “necessarily” incurred for the production of income from his new employer; nor, in our view, was it a payment “exclusively” incurred for the purpose of earning such income because, even if the Appellant felt that it was necessarily so incurred, the payment was not “exclusively”

incurred for that purpose but partly to meet a personal liability of his own. The words "wholly, exclusively and necessarily incurred" in section 12(1)(a) are conjunctive. Furthermore, even if the payment satisfied the criteria mentioned above, it would still not be an allowable deduction if the payment was a capital expenditure (which it may well be) or of a domestic or private nature. As the payment was unconnected with and not related to the Appellant's new employment, it seems to us that in any event the payment was of a private or personal nature so that the payment does not qualify for this additional reason as a deductible expense. The appeal is, therefore, disallowed and the assessment confirmed.