Case No. D34/00

Salaries tax – whether deductible expenses – Inland Revenue Ordinance ('IRO'), section 12(1)(a).

Panel: Ronny Wong Fook Hum SC (chairman), Edward Chow Kam Wah and Shirley Conway.

Date of hearing: 6 May 2000.
Date of decision: 7 July 2000.

The taxpayer claimed deductions for, inter alia, air transport expenses and hotel accommodation expenses for the years of assessment 1995/96 and 1996/97.

Held:

The Board rejected the taxpayer's claim for deductions including these two items. The Board found these expenses of a domestic or private nature and are not wholly, exclusively and necessarily incurred in the production of the assessable income (Ricketts v Colquhoun, Lomax v Newton applied).

Appeal dismissed.

Cases referred to:

D54/94, IRBRD, vol 9, 324
Ricketts v Colquhoun [1926] AC 1
Lomax v Newton [1953] 2 All ER 801

Cheung Lai Chun for the Commissioner of Inland Revenue.
Taxpayer in absentia.

Decision:

Background

1. By letter dated 1 May 1995, Company A offered the Taxpayer ' a position as a financial consultant with the title of vice president' . The Taxpayer' s primary responsibility would be the development of Company A' s ' corporate & institutional business in Hong Kong and the region.' The letter set forth various ' compensation arrangements' between the parties as follows :

(a) ' [The Taxpayer] will be compensated on a commission basis' .

(b) ' [The Taxpayer' s] commission payout will be calculated at a flat 50% for the first year of [his] employment, 40% for the second year and thereafter according to the standard international payout grid in force at the time.'

(c) ' For the first two years of employment [the Taxpayer] will be reimbursed for reasonable travel and entertainment expenses not to exceed 2% of the gross commission..'.

2. The Taxpayer left the United States for Hong Kong on or about 2 October 1995. The cost of his journey was US$1,455.95. Upon arrival in Hong Kong, the Taxpayer stayed in Hotel B in District C. He remained with Hotel B for other periods in the year of assessment 1995/96 when he was in Hong Kong.

3. On or about 15 December 1995, Company A agreed to permit the Taxpayer to draw US$5,000 per month. According to the return of Company A dated 13 May 1996, the Taxpayer was paid HK$231,950 by way of ' salary/wages' in respect of his employment as ' financial consultant' for the period between 1 October 1995 and 31 March 1996.

4. As a result of the transfer of the retail sales and investment banking business from Company A to Company D, the Taxpayer' s employment with Company A was transferred to Company D with effect from 30 September 1996. Company A and Company D assured the Taxpayer that ' we will treat your prior service with [Company A] as service with [Company D] for all purposes of calculating your entitlements as an employee and the terms and conditions of your employment will remain unchanged.'

5. The Taxpayer made four round trips between the United States and Hong Kong in the

year of assessment 1996/97. Whilst he was in Hong Kong, the Taxpayer stayed in various hotels including Hotel B and a sub-let flat in District E.

6. According to the return of Company D dated 30 April 1997, the Taxpayer was paid a total of HK$696,100 by way of ' commission/fee' in respect of his employment as ' financial consultant (vice president)' for the period between 1 April 1996 and 31 March 1997.

7. By an internal memo dated 28 April 1997, the Taxpayer was informed that compensation in respect of his non-capital management business would be revised as from 1 May 1997 as follows :

(a) The accumulated deficit between the Taxpayer' s monthly draw and net commission up to 30 April 1997 ' will be forgiven.'

(b) The Taxpayer' s US$5,000 ' monthly draw from the branch will be terminated. You will be compensated on a commission basis.'

8. In his tax return for the year of assessment 1995/96 dated 2 December 1996, the Taxpayer reported HK$231,950 as income chargeable to salaries tax which accrued to him during the year of assessment by way of ' advance/draw against commission' in respect of his employment as ' financial consultant' of Company A. He claimed the following deductions against such receipts :

Particulars	**Amount HK$**
Hotel	88,209
Air travel	18,000
Per diem expenses	110,050
	216,859

9. In his tax return for the year of assessment 1996/97 submitted to the Revenue on 11 June 1997, the Taxpayer reported HK$696,100 as income chargeable to salaries tax which accrued to him during the year of assessment by way of ' draw against commission' in respect of his employment with Company D. He claimed the following deductions against such receipts :

Particulars	**Amount HK$**
Hotels	166,112.64
Air transportation	39,495.87
Per diem expenses	189,010.80
Life insurance	39,079.25
Health insurance & expenses	73,184.25

	506,882.82

10. By her determination dated 6 November 1998, the Commissioner rejected the Taxpayer' s claims for deductions.

11. By notice of appeal dated 4 December 1998, the Taxpayer challenged the determination of the Commissioner. That notice did not reach this Board until 11 December 1998.

The hearing before us

12. The appeal was initially scheduled to be heard on 4 March 2000. Upon the application of the Taxpayer, we adjourned the hearing of that appeal to 6 May 2000.

13. By letter dated 3 May 2000, the Taxpayer indicated that he would not be attending the hearing fixed on 6 May 2000 due to his unsatisfactory financial circumstances. He outlined in that letter various submissions for our consideration.

Preliminary issue in relation to time

14. The Taxpayer' s notice of appeal dated 4 December 1998 was not received by this Board until 11 December 1998. This was beyond the one month period for appeal stipulated by section 66 of the IRO (Chapter 112).

15. The Revenue however rightly conceded that we should extend time in favour of the Taxpayer given his presence in the United States. We so extend time in favour of the Taxpayer pursuant to section 66(1A) of the IRO.

The substantive issues

16. We have to decide three substantive issues :

(a) whether we should entertain a new ground of appeal put forward for the first time in the Taxpayer' s letter of 3 May 2000.

(b) whether the sums of HK$231,950 and HK$696,100 received by the Taxpayer from Company A and Company D in the years of assessment 1995/96 and 1996/97 have been rightly assessed to salaries tax.

(c) whether the Taxpayer is entitled to the deductions claimed.

The relevant provisions in the IRO

17. Section 8(1)(a) of the IRO lays the charge to salaries tax :

> ' *Salaries tax shall …be charged for each year of assessment on every person in respect of his income …from …any office or employment of profit.'*

18. Section 9(1)(a) of the IRO contains a non-exhaustive definition of ' income from employment' as follows :

> *' Income from any office or employment includes –*
>
> *(a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others …'*

19. For salaries tax purposes, the deductibility of expenses is governed by section 12(1)(a) of the IRO which provides as follows :

> ' *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; …'*

20. Section 66(3) of the IRO provides that :

> ' *Save with the consent of the Board and on such terms as the Board may determine, an appellant may not at the hearing of his appeal rely on any grounds of appeal other than the grounds contained in his statement of grounds of appeal given in accordance with subsection (1).'*

21. Section 68(4) of the IRO provides that :

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

Fresh ground of appeal

22. We are not disposed to exercise our power under section 66(3) of the IRO to permit the Taxpayer to argue that he should be assessed under profits tax and not salaries tax. This new case emerged for the first time in the Taxpayer' s letter of 3 May 2000. It is a hopeless amendment. The relationship between Company A and the Taxpayer was established by the letter of 1 May 1995. It was an ' offer of employment'. The Taxpayer was given a compensation package

comprising various benefits which are normally available to employees and not independent contractors. The ' employment' was continued by the letter of 30 August 1996. Both Company A and Company D submitted employer' s returns in respect of their payments to the Taxpayer. The Taxpayer himself submitted two returns on 10 December 1996 and 11 June 1997 on the basis that he held on ' office or employment' . We are not prepared to entertain his belated change of stance.

Income from employment?

23. Under the terms of the initial engagement dated 1 May 1995, the Taxpayer was to be remunerated on a commission basis in the light of his concluded volume of business. On 15 December 1995, the Taxpayer was permitted to draw US$5,000 per month starting from 1 October 1995 and an advance against future commission from the asset management business. Company A and Company D both filed returns reporting the sums in question as ' salary/wages' and as ' commission/fees' that they paid in favour of the Taxpayer. We have no doubt that the Taxpayer received these sums by virtue of his employment relationship with these two companies. There is no evidence before us indicating that Company A and Company D paid the Taxpayer the sums in question for any other reasons. The Taxpayer in his returns accepted that these sums were income chargeable to salaries tax.

24. There is no evidence indicating either Company A nor Company D imposing any restriction on the mode whereby the US$5,000 could be defrayed. At no time did they instruct the Taxpayer that the draws were to be applied solely to pay outgoings and expenses in Hong Kong.

Deductibility of the amounts claimed

25. In relation to the deductions claimed, the Taxpayer has to prove :

(a) that they were incurred;

(b) that they were not private or domestic in nature;

(c) that they were incurred in the production of his assessable income and

(d) that they were wholly, exclusively and necessarily so incurred.

26. Save for the hotel accommodation expenses and the air transportation expenses, the Taxpayer adduced no evidence to prove the actual incurrence of the other items of expenses claimed. The per diem expenses were mere estimates on the part of the Taxpayer. The Taxpayer failed to surmount the initial hurdle in relation to those items. We therefore confine our further consideration to hotel accommodation expenses and air transport expenses.

27. Similar issues had been considered by this Board in D54/94, IRBRD, vol 9, 324. The Board referred to the statement of Viscount Cave LC in Ricketts v Colquhoun [1926] AC 1 at page 6 :

> ' *A man must eat and sleep somewhere, whether he has or has not been engaged in the administration of justice. Normally he performs those operations in his own home, and if he elects to live away from his work so that he must find board and lodging away from him, that is by his own choice, and not by reason of any necessity arising out of his employment; nor does he, as a rule, eat or sleep in the course of performing his duties, but either before or after their performance'* .

The Board further referred to the statement of Vaisey J in Lomax v Newton [1953] 2 All ER 801 at page 822 :

> ' *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 referable 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.'*

The Board rejected the Taxpayer' s claim for deduction of hotel accommodation and living expenses in Hong Kong. The Board took the view that such expenses are not deductible because they are both expenses of a domestic or private nature and are not wholly, exclusively and necessarily incurred in the production of the assessable income.

28. This case is wholly indistinguishable from D54/94. We reject the Taxpayer' s claims for deduction in respect of his hotel accommodation and air travel.

29. For these reasons, we dismiss the Taxpayer' s appeal.