Case No. D35/04

Salaries tax – deductions – whether reparation to employer 'expenses' – sections 11D, 12(1)(a) and 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Ronny Wong Fook Hum SC (chairman), Vincent Mak Yee Chuen and Alan Wong Chiu Ming.

Date of hearing: 15 May 2004.
Date of decision: 26 August 2004.

The appellant was employed as an Assistant Vice President of Company A. Clause 3(i) of the Employment Contract provided that part of appellant's responsibilities was 'Observe and comply with all the regulations including all credit control policies'.

The appellant and Company A reached agreement in relation to the sum of $267,000 which had been overdue and outstanding in a client's account whereby half of the said sum amounting to $133,500 should be deducted from appellant's withheld commission. The appellant sought to deduct the sum of $133,500 as 'expenses wholly, exclusively and necessarily incurred in the production of the assessable income' under section 12(1)(a) of the IRO. The appellant also made the point that the Revenue had been selective in their assessments in that the Revenue made no attempt to make similar levy against the associate of the appellant.

Company A informed the Revenue that they approved the appellant's client to trade on leveraged FX contract based on the appellant's verbal undertaking that he would be fully responsible for bad debts incurred by his client, which might arise and which would deviate from the practicing credit policy.

Held:

1. The interpretation of section 12(1)(a) is notoriously rigid. As explained by Donovan LJ in Brown v Bullock, the test is whether the duties impose the expense '*In the sense that ... the duties cannot be performed without incurring the particular outlay*'. As indicated by clause 3(i) of the Employment Contract, it was part of the appellant's duties to comply with Company A's credit control policies. The appellant's incurrence of personal liability was not for the performance of such duties but for deviation from such duties. The Board is therefore of the view that the

sum in question does not fall within the test as explained by Donovan LJ in Brown v Bullock.

2. The fiscal position of one appellant may be different from the other. The Board is not persuaded on the evidence before the Board that there was any impropriety in assessing the appellant.

Appeal dismissed.

Case referred to:

Brown v Bullock 40 TC 1

Fung Ka Leung for the Commissioner of Inland Revenue.
Taxpayer represented by his tax representative.

Decision:

1. By letter dated 24 November 1987 ['the Employment Contract'], the Appellant was employed by Company A as its Assistant Vice President. The Employment Contract provided as follows:

(a) By clause 2 that 'You will receive a commission rebate calculated by formulas by the Group from time to time or a basic guaranteed salary in the sum of HK$60,000.00 on a yearly cumulative basis, whichever is higher...However, the basic guaranteed salary or commission rebate shall be reduced by the aggregate amount payable by you as compensation for bad debts and error deals for which you are liable under clause 4(a) below. The amount of deduction made in each month shall be determined by the Group'.

(b) By clause 3(i) that part of the Appellant's 'Responsibilities' was 'Observe and comply with all the regulations including all credit control policies and procedures issued or specified ... by the Group'.

(c) By clause 4(a) that 'If a bad debt/dealing error is found to be a result of your failure to comply with the credit control policy and procedure specified by the Group, you will be liable to make reparation in full unless the Employer decides otherwise, and your liabilities hereunder will be settled as provided in Clause 2 above'.

2. In Company A's employer's return dated 23 May 2002 furnished for the year 2001/02, Company A declared the following particulars of income accruing to the Appellant for the year from 1 April 2001 to 31 March 2002.

Income	**Amount**
Salary/wages	$60,000
Commission/Fees	$250,514
Commission withheld in 1999/2000	$32,618
Commission withheld in 1998/99	$73,580
Commission withheld in 1997/98	$27,301
	$444,013

The three sums of $32,618, $73,580 and $27,301 in respect of commission withheld amounted in total to $133,499.

3. On 28 January 2002, the Appellant and Company A reached agreement in relation to the sum of $267,000 which had been overdue and outstanding in a client's account for a long time. The Appellant and Company A agreed that half of the said sum amounting to $133,500 should be deducted from his withheld commission.

4. Section 11D of the Inland Revenue Ordinance (Chapter 112) ('IRO') provides that:

> *' Provided that for the purposes of this paragraph income which has either been made available to the person to whom it has accrued or has been dealt with on his behalf or according to his directions shall be deemed to have been received by such person'.*

5. The Appellant raised no argument before us as to the application of section 11D. The sole issue before us is whether the Appellant is entitled to deduct the said sum of $133,500 as 'expenses ... wholly, exclusively and necessarily incurred in the production of the assessable income' under section 12(1)(a) of the IRO.

6. 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'*.

7. By letter dated 7 July 2003, Company A informed the Revenue that when a client is under margin call and such situation is not rectified within two days, it will constitute a violation of their credit policy. 'In this particular incident, our Company approved [the Appellant's] client to trade on leveraged FX contract based on [the Appellant's] verbal undertaking that he would be

fully responsible for bad debts incurred by his client, which might arise and which would deviate from the practicing credit policy'.

8. The Appellant did not appear before us. The Appellant's representative made the following points:

(a) He challenged Company A's assertion that there was violation of Company A's credit policy. He said no warning letter was given by Company A to the Appellant.

(b) The Revenue had been selective in their assessments. The Revenue made no attempt to make similar levy against the associate of the Appellant.

9. Section 68(4) of the IRO provides that the onus of proofing that the assessment appealed against is excessive or incorrect shall be on the Appellant. The Appellant tendered no evidence before us to demonstrate that the explanation given by Company A in their letter dated 7 July 2003 is inaccurate or incorrect. We accept that explanation of Company A.

10. As indicated by clause 3(i) of the Employment Contract, it was part of the Appellant's duties to comply with Company A's credit control policies. The Appellant's incurrence of personal liability was not for the performance of such duties but for deviation from such duties. We are therefore of the view that the sum in question does not fall within the test as explained by Donovan LJ in Brown v Bullock.

11. The fiscal position of one taxpayer may be different from the other. We are not persuaded on the evidence before us that there was any impropriety in assessing the Appellant.

12. For these reasons, we dismiss the appeal and confirm the assessments.