INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D36/90

Salaries tax – deduction of expenses – whether expenses were incurred in the performance of the duties, and were wholly, exclusively and necessarily so incurred – three tests to be applied.

Panel: Robert Wei QC (chairman), Vincent To Wai Keung and Harry Wilken.

Dates of hearing: 2 and 3 August 1990.
Date of decision: 15 October 1990.

The taxpayer was employed as a mamasan of a night club. She claimed that she incurred certain expenses in the performance of her duties which should be deducted from her taxable income.

Held:

The onus of proof is on the taxpayer. To succeed the taxpayer must prove:

(1) that the expenses were incurred,

(2) that they were incurred in performance of the duties of a mamasan and

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

The taxpayer was unable to discharge the onus of proof.

Appeal dismissed.

Cases referred to:

CIR v Humphrey 1 HKTC 451
D25/87, IRBRD, vol 2, 400
Lomax v Newton 34 TC 558
Rickets v Colquhoun [1926] AC 1, 4, 6; 10 TC 118
CIR v Burns 1 HKTC 1181
Hillyer v Leek [1976] STC 490
Perrons v Spackman [1981] STC 739
Brown v Bullock 40 TC 1

K A Lancaster for the Commissioner of Inland Revenue.

Robert Lew for the taxpayer.

Decision:

1. This is an appeal by a taxpayer, against the salaries tax assessment raised on her for the year of assessment 1987/88 as revised by the Deputy Commissioner of Inland Revenue in his determination dated 10 May 1990.

2. At all material times the Taxpayer was a mamasan or public relations manageress at a nightclub. Her main contention before the Deputy Commissioner was that as a mamasan she was carrying on an independent business and that her income therefore should be subject to profits tax under section 14(1) of the Inland Revenue Ordinance, and not to salaries tax under section 8(1) of that Ordinance. Before us, however, she abandoned that contention and relied solely on the alternative contention that certain expenses incurred by her amounting to $89,494 (revised from the original claim of $122,501) should be allowed as deductions under section 12(1) from the salaries tax assessment, on the ground that those expenses were wholly, exclusively and necessarily incurred in the production of the assessable income, and not of a domestic or private nature.

3. The claim of $89,494 is made up as follows:

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Building management fee	1,848
Cosmetic expenses	3,125
Entertainment	28,341
Local travelling	4,580
Rent and rates	23,334
Salary	24,000
Telephone	1,565
Utilities	2,701
Total expenses	$89,494

4. The Taxpayer gave evidence and also called two witnesses, Ms X, an office manageress at the nightclub and Ms Y, a hostess at the nightclub. The facts stated in paragraph 1 of the determination are not in dispute. On the evidence the following facts emerge.

5. The Taxpayer has been employed as a mamasan at the nightclub since December 1985. Prior to that she had been a hostess. Upon taking up her employment as a

mamasan she signed an employment agreement. The material terms of which were as follows:

(1) The employer (that is, the nightclub) shall employ the employee (that is, the Taxpayer) as a mamasan from 12 December 1985 to 12 December 1988 for a total period of three years.

(2) The employer shall pay the employee salary or engagement fee of $50,000 on the date of signing the agreement.

(3) The employee is strictly prohibited from working, either full time or part time, for another organisation/company in the same trade or of similar business nature as that of the employer during the above said period covered by this agreement. In case the employee breaches this section of this agreement, a total sum of $100,000 shall be paid to the employer as compensation. The employee shall then also settle all debts/liabilities owed to the employer in one single payment.

5.1 A mamasan is expected to lead to group of hostesses whose job is to entertain customers of the club. It is the duty of a mamasan to provide a customer with a hostess. When a customer visits the club, he can either ask for a particular mamasan through a manager, or, if the customer is new to the club, the mamasans get assigned to him by rotation.

5.2 The club is open from 9 pm to 4 am, and those are the working hours of a mamasan.

5.3 A mamasan is paid $3 for each unit of chargeable hour generated by a hostess under her charge, $2 or less for each unit generated by a hostess on loan to another mamasan, and $1 for each unit if the hostess is borrowed from another mamasan. There are four units to an hour if the hostess keeps customer at the club and six units to an hour if the customer takes the hostess outside of the club.

5.4 The club does not prescribe any minimum number of chargeable units which must be generated through a mamasan's service per evening shift or during any other period of time. A mamasan is free to work at her own pace. She can take as much leave as she cares, although during her absence all of her hostesses will not be considered to be working for her and she earns nothing.

5.5 It is not uncommon for a mamasan to incur expenses in connection with the recruitment and training of hostesses and the entertainment of customers which takes the form of buying them free drinks, dinners or presents.

5.6 While the club welcomes the incurring of those expenses, it does not reimburse them. The management finds that hostesses and customers of a mamasan tend to follow the mamasan when she transfers to another club, and considers that the expenses are incurred to benefit the mamasan more directly than the club. The club does not require the mamasan to incur expenses, and it is entirely a matter for the individual mamasan whether she should incur expenses at all, and if so, how much should be expended.

6. The evidence on the Taxpayer's claim may be summarised as follows.

6.1 It is her case that she teaches hostesses how to dress, how to use cosmetics, how to talk to customers and so on.

6.2 In the year 1987/88 she had about eight to ten hostesses in her charge, with some of them on a part time basis.

6.3 She produced seven hairdresser's bills to support the item 'cosmetic expenses', none of which, however, shows the customer's name.

6.4 She stated that her flat was used partly for private residential purposes and partly for purposes associated with her job as a mamasan. She and her daughter lived in the flat. Every now and then two or three hostesses would sleep or rest after work in the flat.

6.5 She employed an assistant Ms Z who was 17 years old. She worked from 3 pm to 8 pm, taking telephone calls from customers, training hostesses to dress up and applying make-up, taking them to the hairdressers or to buy clothes, collecting repayment of loans from hostesses and customers, and generally deputising for the Taxpayer. She needed her assistance because she had to sleep or rest or otherwise was too busy to do everything herself. She stated that she paid Ms Z a salary of $2,000 per month, but she produced no receipts or any other document to support the claim and offered no explanation of the lack of documentary evidence.

6.6 Nor did she produce any documents to support the item 'local travelling'. It was just an estimate. The expenses were incurred in taking hostesses home or customers who had too much to drink to the car park.

6.7 She produced receipts relating to the items 'building management fee', 'rent and rates', 'utilities' and 'telephone', and her claim is for 100% of the telephone bills and 50% of the bills in respect of the other three items.

6.8 Moving on to the item 'entertainment', the supporting documents were eight promissory notes issued by the Taxpayer to the nightclub and nine receipts issued by restaurants, some of which were addressed to her. There is no

evidence of the customers' names, nor, in the case of the promissory notes, is there any evidence of the specific purpose for which each of them was issued.

7. It is for the Taxpayer to prove that the assessment under appeal is excessive or incorrect (section 68(4)). To do that, it is necessary for her to prove that the expenses in question were wholly, exclusively and necessarily incurred in the production of the assessable income and not of a domestic or private nature. The comparable United Kingdom legislation (the rule) is in the following terms:

> ' If the holder of an office or employment of profit is necessarily obliged to incur and defray out of the emoluments thereof the expenses of travelling in the performance of the duties of the office or employment or of keeping and maintaining a horse to enable him to perform the same, or otherwise to expend money wholly, exclusively and necessarily in the performance of the said duties, there may be deducted from the emoluments to be assessed the expenses so necessarily incurred and defrayed.'

It was held by the Full Court in CIR v Humphrey 1 HKTC 451 at 466 to 477 that the difference in phraseology between the words 'in the performance of the said duties' contained in the third limb of the rule and the words 'in the production of the assessable income' of our legislation is immaterial. It is generally accepted that the United Kingdom principles and tests relating to the words 'wholly, exclusively and necessarily in the performance of the said duties' (that is, the duties of the office or employment) are applicable to claims for deductions under section 12(1)(a). (See, for instance, D25/87.) In Lomax v Newton 34 TC 558 at 562, Vaisey J stated: 'The words are stringent and exacting; compliance with each and every one of them is obligatory if the benefit of the rule is to be claimed successfully.'

7.1 Therefore, to succeed, the Taxpayer must prove: (1) that the expenses were incurred, (2) that they were incurred in the performance of the duties of a mamasan and (3) that they were wholly, exclusively and necessarily so incurred.

7.2 As for the proof of expenses, the Taxpayer is faced with the task of proving that she incurred certain specific expenses and the extent to which they were incurred in the performance of her duties. In the Australian decisions cited in D25/87, emphasis was laid on the requirement of contemporaneous records and details of the expenses incurred, and in relation to entertainment expenses, the need to show with reasonable precision when, where, upon whom the sums concerned were spent, and the person or persons entertained in the process. We would adopt the same approach. Measured by that standard, the evidence summarised in paragraph 6 above on the items 'cosmetic expenses', 'salary', 'local travelling' and 'entertainment' is in our view insufficient and the Taxpayer has failed to discharge her onus in respect of them.

7.3 The Taxpayer was employed as a mamasan, and her duty was to provide customers who asked for her or were introduced to her with hostesses. In exchange, she received an engagement fee at the inception of her employment and acquired the right to earn commission income at fixed rates according to the chargeable units of time generated by her service. It has been held that the words 'in the performance of the duties' mean 'in the course of the performance of the duties and not before or after the performance' (Rickets v Colquhoun [1926] AC 1, 4 and 6; CIR v Humphrey). Furthermore, there is a distinction between expenses incurred in the course of producing income and those incurred for the purpose of producing income; while the former are deductible, the latter are not (CIR v Burns 1 HKTC 1181 at 1189). With the possible exception of entertainment expenses (which in fact have not been proved), the expenses were not incurred in the course of the performance of her duty of providing customers with hostesses, but merely for the purpose of producing income.

7.4 Moving on to the words 'wholly, exclusively', it seems that where an expense is incurred partly in the course of performing duties and partly otherwise, apportionment is possible if a definite portion of it can be isolated and attributed to the performance of the duties (Hillyer v Leek [1976] STC 490 at 492; Perrons v Spackman [1981] STC 739 at 762). Here the Taxpayer is asking for apportionment in respect of the items 'building management fee', 'rent and rates' and 'utilities' and claiming a deduction amounting to 50% of the expenditure. However, there is no evidence to enable apportionment to be done. She is also claiming 100% of the item 'telephone', but there is no evidence to the effect that she never used the telephone for private or domestic purposes. Indeed, it is inconceivable that that could have been the case.

7.5 On the word 'necessarily', Donovan LJ had this to say in Brown v Bullock 40 TC 1 at 10:

> 'Under rule 7 of the rules applicable to schedule E the taxpayer must show that any expense he wishes to be deducted in arriving at his assessable emoluments was, inter alia, necessarily incurred in the performance of the duties of the office or employment. For the taxpayer here it is contended that that is proved by showing that the employer prescribed some duty for his own employee which involved the relevant expense. The General Commissioners seem to have accepted this contention, but in my view it is not correct. The test is not whether the employer imposes the expense but whether the duties do, in the sense that, irrespective of what the employer may prescribe, the duties cannot be performed without incurring the particular outlay. This result follows, in my opinion, from the decision of the House of Lords in Rickets v Colquhoun, 10 TC 118. Mr Monroe has conceded that, even if the Midland Bank did not request and expect the Appellant to join a

> club like the Devonshire Club, he could still perform his duties as bank manager, and that, if the test is the strictly objective one which I have stated, he must fail.' (Emphasis supplied)

The 'expense imposed by duty' test was attributed to the decision in Rickets v Colquhoun, and the test was described as being a strictly objective one. It seems that Donovan LJ was referring, inter alia, to the following words of Lord Blanesburgh at page 7 to 8:

> '… the language of the rule points to the expenses with which it is concerned being only those which each and every occupant of the particular office is necessarily obliged to incur in the performance of its duties – to expenses imposed on each holder necessitate of his office, and to such expenses only … in other words, the terms employed are strictly, and, I cannot doubt, purposely, not personal but objective. The deductible expenses do not extend to those which the holder has to incur mainly, and, it may be, only because of circumstances in relation to his office which are personal to himself or are the result of his own volition.' (Emphasis supplied)

Lord Blanesburgh was construing the word 'necessarily' where it occurs for the first and last time in the rule, that is, in the context of 'is necessarily obliged' and 'so necessarily incurred' respectively, while Donovan LJ was addressing the word in the context of 'necessarily in the performance of the said duties'. Donovan LJ's construction was clearly based on that of Lord Blanesburgh. Applying the objective test to the context of the present case (and assuming, for argument's sake, that the expenses were incurred in the performance of the duties of her employment), the question is whether each and every mamasan has to incur the expenses in question in performing the duties of that employment. To succeed, the Taxpayer has to establish that the answer is yes. In our view, she has failed to do so.

8. Our conclusion is therefore that the Taxpayer has failed to discharge her onus of proof that the revised assessment appealed against is excessive or incorrect. It follows that the appeal is dismissed and that the revised assessment is hereby confirmed.