

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D37/92

Salaries tax – deduction of expenses – whether expenses wholly, exclusively and necessarily incurred and whether expenses had been proved – section 12(1) of the Inland Revenue Ordinance.

Panel: Ronny Wong Fook Hum QC (chairman), Anthony N C Griffiths and David Ling Dah Wai.

Date of hearing: 26 August 1992.

Date of decision: 9 November 1992.

The taxpayer was employed as a sales executive with a basic salary plus commission. The taxpayer was required to visit customers and to entertain customers. The employer reimbursed travelling and entertainment expenses up to the limits of \$500 and \$2,500 per month. The assessor at first allowed the taxpayer a concessionary allowance of 10% of her total income which the taxpayer rejected and claimed a higher amount. The taxpayer was not able to prove to the satisfaction of the assessor that she had incurred travelling and entertainment expenses. The matter was referred to the Commissioner who by his determination withdrew the 10% concession and decided that any amount claimed by the taxpayer in excess of the amounts reimbursed by her employer were not wholly, exclusively and necessarily incurred in the production of the taxpayer's income. The taxpayer appealed to the Board of Review.

Held:

The taxpayer had not proved to the satisfaction of the Board that she had incurred the expenses claimed by her. On the evidence of the taxpayer the Board was satisfied that the taxpayer had incurred entertaining expenses to the extent of \$12,031 but not further or otherwise and allowed the appeal to that extent only.

Appeal allowed in part.

Cases referred to:

D76/90, IRBRD, vol 5, 515

D25/87, IRBRD, vol 2, 400

Australian Board of Review Decision 26 CTBR (NS) Case 69

Stone v FC of T [1918] 28 CLR 389

Australian Board of Review Decision 3 CTBR (NS) Case 28

Australian Board of Review Decision 10 CTBR (NS) Case 47

INLAND REVENUE BOARD OF REVIEW DECISIONS

Australian Board of Review Decision 10 CTBR (NS) Case 109
CIR v Burns 1 HKTC 1181

Ng Kwok Yin for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

THE ISSUE

1. The Taxpayer was first employed on 30 October 1985 by a limited company [‘the Employer’] as sales executive with a basic salary of \$2,500 per month plus commission calculated at a varying scale on the net sales of advertisements in a publication known as ‘Publication A’ as recruited by the Taxpayer.
2. On 21 December 1988, the Taxpayer was promoted to the position of acting account manager. Her basic salary was raised to \$3,800 per month. She was further entitled to commission calculated in accordance with the volume of sales of another publication known as ‘Publication B’.
3. On 15 August 1989, the Taxpayer was again promoted to the position of sales manager. Her basic salary was raised to \$6,000 per month. New and increased target sales figures for Publication A and Publication B were fixed for computation of her commission. The Taxpayer’s basic salary and target sales figures were further revised on 15 December 1989.
4. The Taxpayer filed a 1989/90 salaries tax return where she declared to receive the following income from the Employer in the 1989/1990 year:

<u>INCOME</u>	<u>AMOUNT</u>
Salary/wages	\$68,416
Commission	\$384,579
Bonus	<u>\$10,152</u>
Total:	\$463,147

The Taxpayer claimed the following as allowable deductions to set-off the above total income:

<u>DEDUCTION CLAIMED</u>	<u>AMOUNT</u>
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INLAND REVENUE BOARD OF REVIEW DECISIONS

Entertainment	\$65,157
Travelling	<u>\$27,000</u>
Total:	\$92,157

5. The Taxpayer supplied a bundle of receipts in support of the entertainment expenses that she claimed, copies of those receipts are placed before us.

6. In support of the claim for travelling expenses, the Taxpayer gave the following estimate:

‘Normally a day of work involved 5-6 calls (to clients)

Estimated full working day/year: 250 days

Average number of calls/day: 5/6 calls

Ways of transportation: MTR, van, bus, shuttle bus, taxi and ferries

Location of calls: Tsuen Wan, Shatin, Chaiwan, Quarry Bay, Tsimshatsui, Central, Wanchai, Causeway Bay and North Point

Normal spending time/call: 30-45 minutes.

Normal spending monies/calls per day: \$100-\$150’

7. The assessor allowed 10% of her total income that is \$46,314 as allowable deductions for entertainment and travelling expenses following the then practice of the Revenue to allow certain deductions to salesmen in general.

8. The Taxpayer felt aggrieved by the assessor’s assessment and lodged an objection to the Commissioner of Inland Revenue.

9. By letter dated 13 April 1991, the Employer informed the Commissioner of Inland Revenue the following:

(a) During the year ended 31 March 1990, the Taxpayer was the sales manager of one of the publishing units and responsible for concluding advertising sales for the Employer’s publication products.

(b) The Taxpayer ‘was required to entertain clients and incurred travelling expenses in discharging her duties.’

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (c) The entertainment and travelling expenses incurred by the Taxpayer in connection with her official duties were reimbursed to her. The amount reimbursed during the year ended 31 March 1990 was as follows:

Entertainment Expenses	\$32,172
Travelling Expenses	<u>\$6,000</u>
	\$38,172

- (d) For entertainment expenses, the amount was reimbursed to the Taxpayer on actual consumption basis. For travelling expenses, the amount reimbursed was fixed to be \$500 per month, making a total of \$6,000.

10. By a determination dated 13 January 1992, the Commissioner held that since the Employer reimbursed the Taxpayer for expenses incurred in connection with her official duties, the entertainment and transportation expenses claimed by the Taxpayer over and above the amounts reimbursed were not wholly, exclusively and necessarily incurred in the production of the Taxpayer's income.

11. The 10% concession was accordingly withdrawn. Salaries tax assessment showing net assessable income of \$416,833 with tax payable thereon of \$62,524 was increased by the determination of the Commissioner to net assessable income of \$463,147 with tax payable thereon of \$69,472.

12. The Taxpayer appeals to this Board against the Commissioner's determination.

FURTHER EVIDENCE SINCE THE COMMISSIONER'S DETERMINATION

13. On 13 April 1991, the Taxpayer commented on a record of a telephone conversation between the Taxpayer and the assessor. The following questions and answers are relevant and the words underlined are the handwritten amendments by the Taxpayer.

'Q1: As sales managress of two publications, Publication A and Publication B you are responsible for concluding advertising sales for the two publications. You advised in your letters that you had to call at the offices of your clients. Would you please describe your duties or performance during the interview with your clients?

A1: I have to ascertain the needs of the clients. For example, in the case of cosmetic sales, at different seasons, different cosmetics should be promoted. I present to them the sales kits, including research data, written proposal and also negotiate the price with them. Sometimes, I have to do the 'line-up'. 'Line-up' is applied to special editorial like advertisement package, line-up graphic designs and text write-up.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Q6: Since the sales presentation or interview is taken place at the office of your client, it is not necessary for you to entertain or take lunch or dinner with your clients, is that correct?

A6: No, that is not correct. We have the formal meeting in the office of our clients, but we also have causal meeting during lunch or dinner time.

Q7: What do you do in the causal meeting during lunch time or dinner time?

A7: Most usually, I dine with my clients during lunch time, sometimes it is during dinner time or during happy hours. You know, the atmosphere in restaurants is better than in the offices, it is easier to talk with my clients in a causal manner. Friendly way, no commitment to both parties.

Q8: Can you disclose the normal content of the conversation between you and your clients during those causal meetings?

A8: Sometimes, something is very difficult to discuss in the office of the clients but it is easier to talk to the clients in such causal meetings in the restaurant. For example to learn more about our or their competitors' trading concerns.

Q9: Did you conclude any sales in the causal meetings?

A9: No. Never in my life have I concluded a sale during the causal meetings which I took lunch or dinner with any client or in happy hours. That is against the ICAC regulations (Independent Commission Against Corruption Regulations). As per A7, no commitment to both parties.'

14. By a letter dated 1 May 1992, the Employer sought to clarify the entertainment and travelling expenses that they reimbursed to the Taxpayer, the Employer pointed out that 'There is a ceiling point for [the Taxpayer] which was \$2,500 per month for entertainment and \$500 per month for travelling. In the case if the actual expenses of the month had exceeded the pre-set limit, the employee had to bear the exceeded amount herself.' In a further letter dated 20 August 1992 placed before this Board, the Employer pointed out that in respect of claims for reimbursement of entertainment expenses, 'all original supportings must be submitted by the applicant and no return thereafter'.

15. The Taxpayer gave evidence before us. We are impressed by the straight-forward manner whereby she gave her evidence. She told us that for the two publications that she handled about 150 accounts are involved. It is part of her duty to call up the advertisers and advertising agencies for confirmation of contracts after the contracts are signed. She has to make servicing calls and follow-up calls. It was her normal practice to treat those 150 accounts people to lunch or dinner. The Taxpayer very candidly told us that she does not 'have any witness or any person or any paper or any document that during that lunch or during that entertainment that will generate my income'. The Taxpayer went through the invoices that she tendered in support of her entertainment expenses and

INLAND REVENUE BOARD OF REVIEW DECISIONS

explained to us, insofar as she can recall, the persons (including the name of the client and the nature of the client's business) that she entertained. She was able to be very specific in relation to 5 vouchers pertaining to expenses incurred at Hotel A. She explained to this Board that through a PR company, she mounted an advertising campaign for her clients. Various celebrities in Hong Kong together with press people were invited. The whole campaign generated around \$600,000 for her Employer.

THE APPLICABLE LEGAL PRINCIPLES

16. (a) Section 12(1) of the Inland Revenue Ordinance (Cap 112) provides that there shall be deducted from the income assessable to salaries tax:

‘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.’

- (b) Section 68(4) of that Ordinance places the onus on the Taxpayer to prove that the assessment in question is excessive or incorrect.

17. The decision of the Board of Review D76/90, IRBRD, vol 5, 515 succinctly summarised the construction to be placed on section 12(1)(a):

‘There are many leading cases which make it clear that the deductions permitted for salaries tax purposes are very limited. Expenses must not be of a domestic or private nature. Furthermore they must be wholly incurred in the production of the assessable income, they must be exclusively incurred in the production of the assessable income and in addition they must be necessarily incurred in the production of the assessable income. The word ‘wholly’, ‘exclusively’, and ‘necessarily’ each stand alone and must be given their full meaning. They are not one expression. Before an expense can be deducted, it must comply with all three tests. The word ‘wholly’ means that if an expense is incurred partly for the production of the assessable income but partly for the benefit of the Taxpayer or any other person, the expense is not deductible. It does not matter if the principle object of the expense or the majority of the expense is attributable to the employment. It must be ‘wholly’ attributable to the employment.

The word ‘necessarily’ has also been given a very precise interpretation. The expense must be necessarily incurred in the production of the assessable income. This means that this test has two limbs. The expense must be something which the employee must incur and has no choice. If there is any choice, then it is not necessarily incurred. Secondly, it must be necessarily incurred in the production of the assessable income. This means that it is not sufficient for the employment contract or employer to impose a condition upon the employee if the expense is not incurred in the production of the assessable income.’

18. In D25/87, IRBRD, vol 2, 400 the Board of Review further pointed out that:

INLAND REVENUE BOARD OF REVIEW DECISIONS

‘Even if the Taxpayer proves that some transportation expenses were wholly, exclusively and necessarily incurred in the production of the assessable income, the Taxpayer has to prove the quantum of expenses so incurred. This is a question of fact. In considering whether the onus is discharged we would adopt the approach set out in the commentary in the Australian Income Tax Law Practice Vol 1 at 51/428 dealing with their section 51 and in the Australian Board of Review Decision at 26 CTBR (NS) Case 69.’

The commentary was in these terms:

51/428 Travelling and entertainment expenses

‘The deductibility or otherwise of such expenditure is a question of fact, and the onus of establishing the claim is on taxpayer ... The taxpayer, therefore, is faced with the task of proving that he incurred certain specific expenditure and the extent to which it was incurred in gaining or producing his assessable income. If he fails because he has neglected so to keep his records or vouchers as to show that what he now asserts is correct, he must accept the consequences of his own omission (Stone v FC of T [1918] 28 CLR 389; Australian Board of Review Decision 3 CTBR (NS) Case 28)’

‘... experience and the many decisions of Boards of Review where claims for entertainment, etc. expenses have foundered under the burden of proof, abundantly show the necessity for a taxpayer to keep contemporaneous records of travelling, entertainment and similar expenses. Something more is required of a taxpayer than to give a ‘rough computation’ or a ‘pretty good idea’ or a ‘rough estimate’, when he is claiming a precise amount as outgoings incurred in the earning of his assessable income (Australian Board of Review Decision 10 CTBR (NS) Case 47) ... He must, if called upon, provide with reasonable precision details of expenditure claimed to be deductible (Australian Board of Review Decision 10 CTBR (NS) Cases 47 and 109).’

19. There is a fundamental distinction between expenses incurred in the course of producing income and those incurred for the purpose of producing income; whilst the former are deductible, the latter are not (CIR v Burns 1 HKTC 1181 at 1189).

OUR FINDINGS AND DECISION

20. In relation to the Taxpayer’s claim for travelling expenses, all we have before us is a rough estimate of the Taxpayer. The principle that we cited in paragraph 18 above is directly applicable. We would therefore dismiss her appeal under this head.

21. In relation to the Taxpayer’s claim for entertainment expenses, we accept her evidence that the receipts placed before us are in respect of expenses over and above those which she secured reimbursements from the Employer. We further accept the Employer’s statement in their letter of 13 April 1991 that the Taxpayer was required to entertain clients

INLAND REVENUE BOARD OF REVIEW DECISIONS

in the discharge of her duties. We are not however satisfied that all the receipts tendered by the Taxpayer are in respect of entertainment expenses incurred ‘wholly, exclusively and necessarily’ in the production of her assessable income.

22. We are satisfied that the following 5 invoices do satisfy the statutory tests. They are:

<u>DATE OF EXPENDITURE</u>	<u>HOTEL/RESTARUANT</u>	<u>AMOUNT</u>
	(A Grill	\$852.50
	(A Grill	\$3,624.50
[Date Specified]	(A Grill	\$634.70
	(A	\$2,420.00
	(A	<u>\$4,500.00</u>
		\$12,031.70

We accept that it was part of the Taxpayer’s duty as sales manager of Publication A and Publication B to conduct sales campaign with the help of celebrities and the press. These items were incurred in the performance of that duty. The campaign generated a revenue of \$600,000 to the Employer. It is reasonable to infer that such campaign assisted in the sales of advertisements in the two publications thereby generating additional commission to the Taxpayer. We would therefore allow her appeal to the extent of \$12,031.

23. The remaining receipts of the Taxpayer fall into two categories:

- (a) The first category comprises of vouchers which the Taxpayer can shed no light at all as to the circumstances under which the sums were incurred. The Taxpayer therefore has not even begun to discharge her onus.
- (b) The second category comprises of vouchers which the Taxpayer (on the basis of her own recollection) managed to identify the client with whom she dined but no further. Without additional explanation, we are not satisfied that the expenses were incurred by the Taxpayer wholly, exclusively and necessarily in the course of producing income as opposed to for the purpose of producing income. We would therefore make no further allowance in relation to the receipts falling within this second category.

24. For these reasons, we would allow the appeal to the extent of \$12,031. The net assessable income of \$463,147 with tax payable thereon of \$69,472 as determined by the Commissioner is hereby reduced to net assessable income of \$451,115 with tax payable thereon of \$67,667.

INLAND REVENUE BOARD OF REVIEW DECISIONS