INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D41/92

Salaries tax – whether solicitor can claim cost of clothing as expense.

Panel: Ronny Wong Fook Hum QC (chairman), Colin Cohen and John D Mackie.

Date of hearing: 14 October 1992.
Date of decision: 4 November 1992.

The taxpayer was a female solicitor who claimed to be entitled to deduct from her income assessable to salaries tax part of the cost of the clothes which she wore when acting as a solicitor.

Held:

The cost of a solicitor purchasing clothing is not an expense which is wholly, exclusively, and necessarily incurred. Furthermore it is not permissable to apportion the expense.

Appeal dismissed.

Cases referred to:

Hillyer v Leeke [1976] SDC 490
Mallalieu v Drummond [1983] 2 AC 861
CIR v Humphrey 1 HKTC 451
Ricketts v Colquhoun [1926] AC 1
Taylor v Provan [1975] AC 194
CIR v Hang Seng Bank Limited [1991] HKLR 323

K A Lancaster for the Commissioner of Inland Revenue.
Leo Chiu for the taxpayer.

Decision:

I. THE BACKGROUND

1. The Taxpayer is a practising solicitor employed by a firm in Hong Kong. Her salaries in the year of assessment 1988/89 amounted to $382,103. In correspondence with

the Revenue, she claimed deduction from her salaries a sum of $28,290 (being 50% of her then alleged total expenditure) said to be in respect of clothing etc incurred by her 'wholly, exclusively and necessarily' in the production of her income.

2. Her claim was rejected on 26 September 1989 when the assessor issued to the Taxpayer a salaries tax assessment for 1988/89 as follows:

Principal Income	$382,103
Tax thereon	$59,225

3. On 31 October 1989, the Taxpayer objected against her 1988/89 salaries tax assessment in the following terms:

> 'I submit that the clothing etc expenditure was incurred by me wholly, exclusively and necessarily in the production of my income for the following reasons:
>
> (a) I would not have incurred the expenditure but for the fact that I am a solicitor and therefore have to be properly dressed. Only 50% of the total expenditure is claimed which I believe to be a reasonable apportionment and takes full account of any personal benefit which I may derive from the clothings etc. The expenditure was therefore incurred 'wholly' for the production of income.
>
> (b) The expenditure was also incurred 'exclusively' for the production of income. I would, in this connection reiterate that it is not 100% of the total amount spent that is being claimed as a deductible expenditure. Only 50% of such amount is claimed as expenditure. In other words, whatever may be the correct view on the total amount of the expenditure as a whole is irrelevant, since it is not the total amount that is being claimed as a deduction. The issue is whether the 50% of the total can properly be treated as expense incurred 'exclusively' for the production of income. In this connection, I would draw your attention to the fact that I do not wear the clothes I bought to <u>and from</u> work. I always change into casual wear after work before departing from my office. I do not wear any of the clothes etc in question after work or on holidays.
>
> (c) As pointed out above, I am a solicitor and therefore have to be properly dressed. If I were not a solicitor, I would not have bought the clothes I did.'

4. After lodging her objection, the Taxpayer on 6 August 1990 applied for personal assessment.

5. By a determination dated 11 June 1992, the Commissioner rejected the Taxpayer's objections and affirmed the assessment. The Taxpayer appealed against that determination in July 1992. Annexed to the notice of appeal is a 'statement of grounds of appeal'.

6. The Taxpayer placed before us a bundle of vouchers in relation to the expenditure allegedly incurred by her on clothing and other items in the year of assessment 1988/89. Those vouchers can be summarised as follows:

DATE		SHOP	NO. OF ITEMS	NATURE OF EXPENDITURE IN SO FAR AS IT CAN BE ASCERTAINED	AMOUNT	TOTAL FOR MONTH
August 1988	(		4		$7,640	
August 1988	(		1		$6,000	$13,640
September 1988	(		2		$2,155	
September 1988	(		1	Shirt	$425	
September 1988	(		2		$915	
September 1988	(		1		$367	
September 1988	(		2	Shirts	$810	$4,673
October 1988	(		3		$7,965	
October 1988	(	names	1		$585	$8,550
November 1988	(	specified	1		$3,380	
November 1988	(		3		$6,885	
November 1988	(		1	Belt	$855	
November 1988	(		1		$4,680	$15,800
					carried forward:	$42,663
January 1989	(		2		$4,838	
January 1989	(		1		$4,375	
	(		1	Dress	$2,400	

	(	1	Shoes	$650	
January 1989	(	1	Scarf	$595	$12,858
February 1989	(	2		$4,680	$4,680
March 1989	(names	1		$3,780	$3,780
	specified			GRAND TOTAL:	$63,981
				[50%:	31,990]

7. It is common ground between the Taxpayer and the Revenue that two issues call for our determination:

(a) Whether on the basis of the application for personal assessment made by the Taxpayer on 6 August 1990, the Taxpayer should have been assessed for salaries tax at all.

(b) Whether the sum of $31,990.50 was incurred by her wholly, exclusively and necessarily in the production of her assessable income for the purpose of section 12(1)(a) of the Inland Revenue Ordinance.

II. WAS THE APPLICATION FOR PERSONAL ASSESSMENT A BAR

8. The Taxpayer did not give any evidence before us. The Revenue however accepted that the Taxpayer would change into her casual wear after work but contended that that fact makes no difference in law.

9. Mr Chiu for the Taxpayer made no attempt to amplify the basis of the Taxpayer's contention that by virtue of her application for personal assessment the Taxpayer should not have been assessed for salaries tax at all.

10. We accept the Revenue's contention that part VII of the Inland Revenue Ordinance does not preclude the assessment of a taxpayer's various sources of income to property tax, salaries tax or profits tax. On the contrary, it recognises that such tax may have been charged by way of assessment and directs that such tax which has been paid be set off against any tax due under personal assessment. There is nothing in part VII of the Inland Revenue Ordinance which says that a salaries tax assessment cannot be raised if personal assessment is elected. We have no difficulty in rejecting this ground of appeal on the part of the Taxpayer.

III. THE TAXPAYER'S CONTENTIONS ON DEDUCTIBILITY OF $31,990

11. The Taxpayer's contentions can be summarised thus:

(a) Whatever may be the correct view on the total amount of the expenditure as a whole is irrelevant, since it is not the total amount that is being claimed as a deduction.

(b) The word 'wholly' in the statutory test is satisfied because the claim is confined to 50%.

(c) The word 'exclusively' in the statutory test is likewise satisfied as the issue relates to 50% of the total.

(d) Whether an expense was 'necessarily' incurred depends on an 'objective subjective test'. An expense incurred in accordance with the requirements of the Taxpayer's contract of employment must necessarily be incurred in the production of income. In this respect, the Taxpayer contends that it is an implied term of her contract of employment with her employer that 'she must be well attired and otherwise presentable so that she would instill confidence in herself and her employing firm'. Mr Chiu for the Taxpayer invites us to take judicial notice of what he termed 'power dressing' which he described thus:

> 'Power dressing is not about wearing jeans or whatever fits comfortably on a man or a woman, it is about bringing respectability to one's work, to one's presence. If expenses have to be incurred in order to bring about that respectability or presence because of the nature of one's work, then the expense must be properly incurred and necessarily incurred.'

(e) The Taxpayer further argues that even if the expenditure were incurred for dual purposes, the Board has jurisdiction to apportion the expenditure amongst the different purposes. When questioned as to the basis of such apportionment, Mr Chiu said:

> 'The 50/50 apportionment chosen on a very generous basis and that even if the Commissioner should be of the view or the Board should be of the view that there was a duality of purposes, then the Taxpayer is prepared to accept that half of the benefit went to her as a person … and the other half … is attributable to the fact that it was an expense wholly, exclusively and necessarily incurred in the production of income …'

IV. OUR DECISION

12. We reject the Taxpayer's contention that it is irrelevant to consider the nature of the total amount of each item of expenditure. The question is not whether a sum arrived at by application of an arbitrary percentage unilaterally selected by the Taxpayer satisfies the statutory test. The question is whether each item of expenditure when incurred meets the statutory criteria.

13. In Hillyer v Leeke [1976] SDC 490 a computer engineer claimed relief for £ 50 in respect of his private suits worn only for the purpose of his work. It was argued before Goulding J that the money was expended 'wholly, exclusively and necessarily' in the performance of the Taxpayer's duty pursuant to section 189 of the Income and Corporation Taxes Act 1970 as applicable to the English Schedule E. The Learned Judge rejected that contention. The Learned Judge took the view that:

> 'The truth is that the employee has to wear something, and the nature of his job dictates what that something will be. It cannot be said that the expense of his clothing is wholly or exclusively incurred in the performance of the duties of the employment.'

As an alternative ground, the Learned Judge further held that the expenditure was not incurred 'necessarily' in the performance of the duty. He said:

> 'Consider two persons doing the same work and also require to wear clothing of a certain standard. One of them wears his suits indiscriminately when on duty and when not on duty. They wear out quicker because of the stress imposed on them by his occupation, but he does not change the moment he comes off duties; he just uses his suits as many people do, to wear in the evenings and on Sundays as well as while at work. The other person … keeps a suit or suits exclusively to wear at work and always changes. It would be strange if the tax situation of those individuals were different because of that difference in their private habits; but under Schedule E, I think it is clear that it would not be different. Apart from any other elements in the case, the first individual would come up against the words 'wholly' and 'exclusively', and the second individual would come up against the word 'necessarily', because there is no necessity that he should restrict any particular suit to working hours and, if he liked, he could do the same as his colleague in the first example. That is an alternative ground on which this case could, in my view, be decided, and I rely on both grounds.'

14. Hillyer v Leeke was considered and approved by the House of Lords in Mallalieu v Drummond [1983] 2 AC 861. In Mallalieu, the Taxpayer's barrister sought to deduct the costs of upkeep of a wardrobe of clothes bought in compliance with the Notes for Guidance of the Bar Council on the basis that the same were 'wholly and exclusively laid out or expended for the purposes of her profession' under section 130 of the Income and Corporation Taxes Act 1970. The House of Lord held that:

(a) 'The effect of the word "exclusively" is to preclude a deduction if it appear that the expenditure was not only to serve the purposes of the trade, profession or vocation of the taxpayer but also to serve some other purposes. Such other purposes, if found to exist will usually be the private purposes of the taxpayer.' [page 870C]

(b) To ascertain whether the money was expended to serve the purposes of the Taxpayer's business it is necessary to discover the Taxpayer's 'object' in making the expenditure. [page 870D]

(c) If it appears that the object of the Taxpayer at the time of the expenditure was to serve two purposes, the purposes of his business and other purposes, it is immaterial to the application of section 130(a) that the business purposes are the predominant purposes intended to be served. [page 870E]

(d) '… it is inescapable that one object, though not a conscious motive, was the provision of the clothing that she needed as a human being. I reject the notion that the object of a taxpayer is inevitably limited to the particular conscious motive in mind at the moment of expenditure. Of course the motive of which the taxpayer is conscious is of vital significance, but it is not inevitably the only object which the Commissioners are entitled to find to exist.' [page 875D]

15. Mr Chiu reminded us that the English provisions relate to expenditure in the performance of the Taxpayer's duties whilst the local legislation refers to 'in the production of such assessable income'. In CIR v Humphrey 1 HKTC 451, the full court treated the words 'in the production of such assessable income' contained in the then section 12(1)(b) which corresponded to the current section 12(1)(a) as having the same meaning as the words 'in the performance of the duties of the office or employment' contained in comparable UK legislation. Furthermore, that distinction does not affect the meaning to be attributed to the words 'wholly', 'exclusively' and 'necessarily'. We would therefore follow the ratio of both Hillyer and Mallalieu.

16. We hold that each item of clothing when acquired by the Taxpayer was for the dual purposes of keeping up her appearances at work and for the provision of clothing that she needed as a human being. Such duality of purposes was indeed tacitly recognised by the Taxpayer's whole approach in this case. It is vital to keep firmly in mind that the Taxpayer is not seeking deduction of the entire amount of $63,981 but 50% of the same amounting to $31,990. Her approach is exemplified by this statement in her letter of 31 October 1989:

> 'Only 50% of the total expenditure is claimed, which I believe to be reasonable apportionment and takes full account of any personal benefit which I may derive from the clothing etc.'

This approach must entail acceptance by the Taxpayer that each item of expenditure involved dual purposes. Any other view would not make sense to the 50% claim. Had each item of expenditure when incurred was for the sole purpose of the production of assessable income, there would have been no logical basis for confining the claim to the sum of $31,990. We therefore hold that the deduction claimed failed to satisfy the words 'wholly' and 'exclusively' in the statutory test.

17. The deduction claimed must further satisfy the word 'necessarily' in the statutory test. The word 'necessarily' in the United Kingdom rule was interpreted by Lord Blanesburgh in Ricketts v Colquhoun [1926] AC 1 at pages 7 to 8 as follows:

> '… 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 ex-necessitate of his office, and to such expenses only … 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.'

18. As pointed out by Lord Wilberforce in Taylor v Provan [1975] AC 194 at 218:

> 'If, as I believe to be the law, expenses incurred on account of personal circumstances are not deductible under the rule, they cannot be made so merely by the technique, or device, of injecting them into the contract of employment. To hold that they could, and would invite the creation of arrangements which might not correspond with reality and which would produce gross inequality of treatment. The Commissioner must always have the right to examine the whole circumstances and to decide what, objectively, the duties of the office or employment were and what was necessary in the performance.'

19. There is no evidence before us to demonstrate the nature of each of the alleged item of clothing purchased. No explanation was given for the regularity or the quantum of each purchase. The Taxpayer's case rests not on an express term of her contract of employment but on an implied term reinforced by the notion of 'power dressing'. Mr Chiu argued that:

> 'I think it's accepted that a $800 suit just doesn't look the same as the $8,000 one, the $8,000 much less than the $18,000 suit. Hong Kong is a society when one has to be smartly dressed to go anywhere in business or employment. A shabbily dressed solicitor is not going to command a lot of respect from his clients and a solicitor without clients will not go very far up the career ladder or within a solicitor's firm.'

20. Whilst we accept that a solicitor must dress with good taste, common sense and appropriate to the dignity of her profession, we reject the suggestion that it is an implied term of a solicitor's employment that she should attempt to dress as lavishly as possible. The statutory test is 'necessarily' incurred in the production of assessable income and the pronouncements of Goulding J in Hillyer v Leeke is relevant in this respect:

> 'The law does not in all cases allow a taxpayer, in ascertaining his taxable emoluments, to deduct the extra expenses that may arise from his employment. It is very well known that one's job may in popular parlace be more expensive than another because it requires the person holding it to keep up appearances

> more, to maintain a higher apparent standard of living, which, so far as the items of expenditure cannot be isolated and attributed solely to the performance of the duties, will not be reflected in a deduction from his taxable emoluments. To take a very obvious example, some jobs require the person holding them to work in the open air in very cold weather, so making that person hungrier than he would be if he were sitting in a warm office, but it is quite clear that he could not charge extra nourishment arising from those circumstances against his taxable emoluments.'

For these reasons, we reject the Taxpayer's claim on the additional basis that she has not discharged the onus in demonstrating to us that each item of expenditure was 'necessarily' incurred in the production of her assessable income.

21. Mr Chiu sought to equate the Taxpayer's position with the 'uniform' type of case. There is no evidence before us on the material and design of the clothing in question. There is nothing to suggest that the clothing purchased was dictated by the practical requirements of the work of a solicitor. We reject this argument.

22. Once this stage is reached, we are of the view that there is no jurisdiction to apportion each item of expenditure amongst the purposes for which the expenditure we incurred. We accept the Revenue's contention that the following dictum of Lord Bridge in CIR v Hang Seng Bank Limited [1991] HKLR 323 at page 331C is not of general application. Lord Bridge stated thus:

> 'There may, of course, be case where the gross profits deriving from an individual transaction will have arisen in or derived from different places. Thus, for example, goods sold outside Hong Kong may have been subject to manufacturing and finishing process which took place partly in Hong Kong and partly overseas. In such a case, the absence of a specific provision for apportionment in the Inland Revenue Ordinance would not obviate the necessity to apportion the gross profit on sales as having arisen partly in Hong Kong and partly outside Hong Kong.'

This dictum was said in the context of a decision on section 16 of the Inland Revenue Ordinance which provides as follows:

> '16. Ascertainment of chargeable profits:
>
> (a) In ascertaining the profits in respect of which a person is chargeable to tax under this part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basic period for that year of assessment.'

This is to be contrasted with section 12(1) of the Inland Revenue Ordinance which provides:

> 'In ascertaining the net assessable income of a 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.'

Section 16 therefore allows expenditure to be deducted 'to the extent to which it was incurred.' This tacitly recognises that apportionment is permissible. Section 12(1)(a) contains no similar wordings. Even if we be wrong on the jurisdiction to effect apportionment, we find that the Taxpayer failed to discharge her onus in adducing evidence before us as to enable that jurisdiction to be exercised judically. The matter cannot rest on the Taxpayer's own concession, however generous that may be.

23. For these reasons we would dismiss the Taxpayer's appeal and affirm the salaries tax assessment for the year of assessment 1988/89.