INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D8/99

Salary Tax – allowable deductions – meaning of 'outgoings and expenses' – whether taxpayer entitled to claim deductions – section 12(1)(a) of the Inland Revenue Ordinance.

Panel: Benjamin Yu SC (chairman), Vincent To Wai Keung and Lily Yew Kuin King Suk.

Date of hearing: 24 March 1999.
Date of decision: 29 April 1999.

The taxpayer, who was employed as a lecturer in a university, appealed against the assessment concerned on the ground that he was entitled to claim deduction on certain items. The appeal focused mainly on two issues: (i) whether the taxpayer could establish that the sums concerned, were expanses or outgoings and (ii) if so, whether these were wholly, exclusively and necessarily incurred in the production of the assessable income.

Held, dismissing the appeal:

(1) 'Outgoings and expenses' were not defined in the IRO. They would include not only disbursements, but also a sum which there was an obligation to pay: See Commissioner of Inland Revenue v Lo & Lo [1984] 1 WLR 986 at page 992B.

(2) The Board found it difficult to accept that money or books lost either because of theft or otherwise could be regarded as outgoings or expenses. If a person kept his money in a locked cabinet and found it stolen, it could hardly be described as an item of expenses incurred by the person.

(3) It was also debatable whether the loss suffered by the taxpayer in having over-ordered the books and in granting a discount to the students could be regarded as an expense.

(4) It seemed to the Board that all the items claimed for deduction could only be regarded as expenses incurred by the taxpayer if they were considered from the point of view of the taxpayer's initial outlay or liability in the purchase of books. That initial outlay or liability was subsequently reduced by the proceeds of sale of the books recovered from the students, leaving a shortfall which represented the taxpayer's expenditure in the whole undertaking.

(5) The Board must therefore consider whether the taxpayer's initial outlay was 'wholly exclusively and necessarily incurred in the production of his assessable income.'

(6) The Board agreed that guidance on the construction of the local section 12(1)(a) could be obtained from the UK cases on the corresponding provision in the UK statute. However, it was necessary to exercise caution when seeking to apply the reasoning in those cases directly. One had to see whether the difference in wording may be material in the particular case.

(7) Following the approach laid down in Fitzpatrick v IRC, the question that the Board should ask itself is whether on the facts and upon the true construction of section 12(1)(a), the taxpayer incurred expense in the performance of his duties when he incurred the expense or liability in purchasing the books for the students.

(8) The taxpayer contended that it was part of his teaching duties to compile teaching materials and ensure that the necessary teaching materials reach the hands of the student. While the Board were prepared to accept that it was part of his teaching duties to develop, review and redesign courses as well as to develop teaching materials, it had difficulty in accepting that he had any duty to undertake the purchase and sale of books. The evidence was in fact to the contrary.

(9) There was no necessity for the teaching materials to be disseminated in the form of a textbook, and undertaking by the taxpayer in purchasing the books and reselling them to the students could not be said to be necessary for the production of his income or the performance of his duties.

(10) Thus, while the Board found the taxpayer's motive to be laudable and it had no doubt that what he did is in the best interests of his students, the Board was unable to hold that his voluntary decision to purchase the books or the resultant loss that he incurred could be said to be 'necessarily incurred in the production of the assessable income'.

Appeal dismissed.

Cases referred to:

Commissioner of Inland Revenue v Lo & Lo [1984] 1 WLR 986
Commissioner of Inland Revenue v Humphrey 1 HKTC 451
D89/89, IRBRD, vol 6, 328
Ricketts v Colquhoun 10 TC 118
Nolder v Walters 15 TC 380
Fitzpatrick v IRC [1994] 1 WLR 306
Simpson v Tate [1925] 2 KB 214

Chow Cheong Po for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal by the Taxpayer against the determination by the Commissioner of Inland Revenue dated 29 September 1998. By that determination, the Commissioner confirmed the assessment of salaries tax assessment for the year of assessment 1996/97 raised on the Taxpayer and rejected the Taxpayer's claim for deduction under section 12(1)(a) of the Inland Revenue Ordinance (the IRO). What is in issue in this appeal is whether the Taxpayer is entitled to claim deduction.

2. During the year of assessment 1996/97, the Taxpayer was employed as a lecturer in a university (hereinafter referred to as 'the University'). His return for that year claimed the following deductions:

Books provided to students

Loss and theft of cash	$35,988
Book subsidy for students	$30,627.7
Losses	$28,080
Total	$94,695.7

3. In subsequent correspondence with the Commissioner, the Taxpayer maintained his claim for deduction, but at $66,616.16, made up of the following elements:

(1)	Missing books and cash	$6,162.46
(2)	Discounts granted to students due to late delivery	$18.992
(3)	Unsold copied that became redundant	$11,635.7
(4)	Loss of cash due to theft	$29,826
	Total	$66,616.16

Nothing turns on the difference in the amount of his claim. The Respondent (the CIR) has not challenged any of these figures.

4. The Taxpayer gave evidence at the hearing of the appeal. He also called Dr C, director of the language centre of the University to give evidence on his behalf.

5. We accept the evidence from the Taxpayer and Dr C as to primary facts. Based on their evidence and the documents placed in front of the Board, we make the following findings of fact:

(1) The Taxpayer joined the University in August 1995 on a 3-year contract.

(2) As a lecturer, the Taxpayer's duties and responsibilities are teaching, research and providing administrative support to his department.

(3) The University regarded teaching as involving more than mere instruction in class. Teaching included, *inter alia*, developing, reviewing and redesigning courses as well as developing teaching materials.

(4) During his first academic year with the University, that is 1995-1996, the Taxpayer relied on standard textbooks and also used materials he prepared for instructing the students. The materials he prepared were in the form of loosely bound volumes. These were distributed to the students at cost. His department handled the binding, the distribution of the materials and the collection of the charges.

(5) Some time later, the Taxpayer acceded to a suggestion from a foreign publisher to compile his materials into a textbook called Book A. The Taxpayer reckoned that the cost of the textbook to the students should be about the same as the loosely bound materials.

(6) In the spring term of 1997, the Taxpayer assigned 2 textbooks for his course at the University, namely Book A and another textbook written by another author called Book B.

(7) The Taxpayer found that although some 270 students had enrolled for the course, the University's bookstore only ordered about 100 copies of the 2 books. He was concerned that nearly 2/3 of the students would be left without a copy. He took the initiative of cancelling the order made by the University's bookstore, to be replaced by orders he placed through his department with the publishers. He intended to sell the books he ordered to the students 'at cost'. In the case of Book B, this represented at least a 20% discount on the published price and in the case of Book A, cost included only the cost of publishing and shipping, with no markup and no royalties.

(8) Since the orders for the 2 books were placed through the department, the department had to pay the publishers and the Taxpayer reimbursed the department for the purchase.

(9) The books ordered from the foreign publishers were originally due to arrive in February 1997. In the event, the books did not arrive until late April. To induce the students to take the books, he offered a 50% discount on the cost price to the students. He thereby incurred a loss of $18,992.

(10) Book B was obtained on consignment and unsold copies were returned to the publisher. The publisher for Book A, however, would not accept any returns. The Taxpayer found in the end that he was left with some 67 books unsold. These unsold books had no commercial value because they came from a special first printing with quick binding and subsequent prints were not only in hardcover but contained revision in the text.

(11) The Taxpayer enlisted the assistance of three graduate students to assist him in handling the sale and distribution of the books. When final tallying was done, 6 books and some $6,162.46 were found to be short.

(12) The Taxpayer did not want to mix his own money with the cash that was collected from the students. He stowed the cash in a locked cabinet in the department office but later discovered some $29,826 missing.

(13) Some of the lecturers at the University published their own books. But lecturers can also rely on the University to do the printing and distribution of the materials to the students. For some time, the University had printed teaching materials and supplied them free of charge to the students. Since about 1995, the University decided to charge the students for the cost of printing the teaching materials produced by the lecturers.

6. In order to succeed on the claim for reduction, the Taxpayer has to satisfy this Board that the amounts in question fall within the terms of section 12(1)(a) of the IRO which provides:

> *'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 that expenses of a domestic or private nature and capital expenditure, wholly, exclusively and necessarily incurred in the production of the assessable income.'*
>
> Section 68(4) of the IRO makes it clear that the burden is on the Taxpayer to satisfy the Board that the assessment was excessive or incorrect.

7. The appeal raises the following questions: (i) whether the Taxpayer can establish that the sums in question, were expenses or outgoings, and (ii) if so, whether these were wholly, exclusively and necessarily incurred in the production of the assessable income.

8. We turn to the first question. Are the amounts in question expenses or outgoings? 'Outgoings and expenses' are not defined in the IRO. They would include not only disbursements, but also a sum which there is an obligation to pay, see **Commissioner of Inland Revenue v Lo & Lo** [1984] 1 WLR 986 at page 992B. That was a case concerned with the meaning of the term 'outgoings and expenses' in section 16 of the IRO.

9. We find it difficult to accept that money or books lost either because of theft or otherwise could be regarded as outgings or expenses. If a person kept his money in a locked cabinet and found it stolen, it could hardly be described as an item of expense incurred by the person. It is also debatable whether the loss suffered by the Taxpayer in having over-ordered the books and in granting a discount to the students could be regarded as an expense.

10. It seems to us that all the items claimed for deduction could only be regarded as expenses incurred by the Taxpayer if they are considered from the point of view of the Taxpayer's initial outlay or liability in the purchase of the books. That initial outlay or liability was subsequently reduced by the proceeds of sale of the books recovered from the students, leaving a shortfall which represented the Taxpayer's expenditure in the whole undertaking.

11. We must therefore consider whether the Taxpayer's initial outlay was 'wholly exclusively and necessarily incurred in the production of (his) assessable income.'

12. In **Commissioner of Inland Revenue v Humphrey** 1 HKTC 451, Blair-Kerr J compared the words 'in the production of such assessable income' (then in section 12(1)(b) of the IRO) with the requirements laid down in Rule 9 of the Deduction Rules applicable to Schedule E of the UK **Income Tax Act 1918**. Rule 9 of the Deduction Rules provides:

> 'If the holder of an office or employment of profit is necessarily obliged to incur and defray out of the emolument 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.'

Blair-Kerr J came to the conclusion that while the relevant provisions of the English Act were not in the same terms as those of the local statute, the difference in phraseology was immaterial for the purposes of the appeal. He noted that counsel for the Taxpayer saw no substantial difference in the effect of the two phrases 'in the performance of the duties of the office or employment' and 'in the production of such assessable income' at least so far as the appeal was concerned. This Board in D89/89, IRBRD, vol 6, 328 was concerned with the question whether the expense incurred by a lecturer in attending an overseas conference was deductible. The Board said:

> *'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 dealing with the deduction of expenses from emoluments, that is, the Income Tax Act 1952, schedule 9, paragraph 7. It has been generally accepted that the UK principles and tests relating to the application of those words and the word "necessarily" are applicable to claims for deductions under section 12(1)(a). So the issue in the present case is in effect whether the conference expenditure was necessarily incurred in the performance of the duties of the Taxpayer as a senior lecturer in the Taxpayer's academic discipline. This involves two questions: (1) whether the expenditure was incurred in the performance of duties, and (2) whether it was necessarily so incurred.'*

13. We agree that guidance on the construction of our section 12(1)(a) could be obtained from the UK cases on the corresponding provision in the UK statute. However, it is necessary to exercise caution when seeking to apply the reasoning in those cases directly. One has to see whether the difference in wording may be material in the particular case. We start with **Ricketts v Colquhoun** 10 TC 118 relied on by the Respondent (the CIR). That was a case where a barrister's claim for deduction of the cost of travelling between London and Portsmouth in order to attend the Quarter Sessions as a Recorder and his accommodation expense in Portsmouth was rejected. At page 135, Lord Blanesburgh said:

> *'This Rule 9 deals with the permissibly deductible expenses of offices so diverse in character that the performance of their different duties call for every form of activity and repose ... Undoubtedly its most striking characteristic is its jealously restricted language, some of it repeated apparently to heighten its effect. But I am also struck by this, that, as it seems to me, although undoubtedly less obtrusively, the language of the Rule points to the expenses with which it is concerned as being confined to those which each and every occupant of the particular office is necessarily obliged to incur in the performance of its duties, to expenses imposed upon each holder ex necessitate of his office and to such expenses only. It says: - "If the holder of an office" – the words be it observed are not "if any holder of an office" – "is obliged to incur "expenses in the performance of the duties of the office" – the duties again are not the duties of his office; 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.'*

In so far as Lord Blanesbugh derived some assistance from the fact that Rule 9 used the expression '*if the holder of an office*' rather than '*if any holder of an office*', that reasoning

would not be applicable in the construction of section 12(1)(a). Pollock MR at page 124 based his reasoning on the words 'necessarily obliged'. He said:

> *'Now the first thing is this, that at the outset you have to find that the holder is necessarily obliged to incur and defray expenses out of his emoluments, and I attach importance to those words "necessarily obliged" because I think they are to be read as meaning this, that where an obligation is imposed upon the holder of the office which ex necessitate of the office compels him to make outlays, it is in those cases, and after you have fulfilled that condition, that you first begin to consider what is the possible expenditure which may be deducted.'*

Again, in so far as Pollock MR in that passage relied on the words 'necessarily obliged' which are absent in our section 12(1)(a), we doubt whether we could safely apply his reasoning to guide us. We observe that the UK provision has two limbs, and it is the second limb which bears a closer resemblance to our provision.

14. In **Nolder v Walters** 15 TC 380, an airline pilot claimed deduction of a portion of the expense of the upkeep of a motor car on the basis that it was necessary for him to keep the car since his duties often commenced and ended when public transport was not available. Rowlatt J said (at page 387):

> *'"In the performance of the duties" means in doing the work of the office, in doing the things which it is his duty to do while doing the work of the office. A man who holds an office or employment has, equally necessarily, to do other things incidentally, and spend money incidentally, because he has the office. He has to get to the place of employment for one thing. If he had not got the employment he could stay at home. As he has got the employment he has necessarily got to get there and it costs him something if it is only shoe leather, to get there; but that is not in the performance of the office, because in getting there he is not doing the duties, or doing the work of the office. Incidentally, he is obliged to do that, but it is not in doing the work of the office, which begins when he arrives and sets to work to perform his duties ... I do not think (he) can be allowed the use of his motor car ... his employers would not be liable for what he did while he was driving his motor car to the office. He is not under their commands while he is going to the office, not in the sense that they govern his going. He has to be at the office wherever he has to start from ...'*

15. More recently, in **Fitzpatrick v Inland Revenue Commissioners** [1994] 1 WLR 306, the House of Lords had to consider two appeals respectively from England and Scotland from 10 journalists claiming deduction under section 189 of the Income and Corporation Taxes Act 1970 for expenses incurred in purchasing newspapers and periodicals. In the Scottish appeals, the special commissioners made a finding that the reading of newspapers and periodicals by the journalists was to provide them with the background material to approach their duties, but were not at that time preparing articles for publication in the course of the performance of their duties. The taxpayer appealed. In the

English appeals, the commissioners allowed the claim, holding that the amounts claimed were in respect of expenditure incurred wholly, exclusively and necessarily in the performance of the taxpayer's duties and accordingly deductible. The Crown appealed. The House of Lords dismissed the Scottish appeals and, by a majority (with Lord Browne-Wilkinson dissenting) allowed the English appeals. The net result was that all claims were disallowed. Lord Templeman cited *Simpson v Tate* [1925] 2 KB 214, a case where a medical officer joined certain medical and scientific societies in order that by means of their meetings and published transactions, he might be aware of all recent advances in sanitary science and keep himself up to date on all medical questions. Rowlatt J said in that case (at page 219):

> *'The respondent qualified himself for his office before he was appointed to it, and he has very properly endeavoured to continue qualifying by joining certain professional and scientific societies, so that by attending their meetings and procuring their publications he may keep abreast of the highest developments and knowledge of the day. He seeks to deduct from his assessable income the subscriptions paid by him to these societies as money expended necessarily in the performance of the duties of the office. When one looks into the matter closely, however, one sees that these are not moneys expended in the performance of his official duties. He does not incur these expenses in conducting professional inquiries or get the journals in order to read them to the patients. If he did, the case would be altogether different. He incurs these expenses in qualifying himself for continuing to hold his office, just as before being appointed to the office he qualified himself for obtaining it ... In my view the principle is that the holder of a public office is not entitled ... to deduct any expenses which he incurs for the purpose of keeping himself fit for performing the duties of the office, such as subscriptions to professional societies, the cost of professional literature and other outgoings of that sort. If deductions of that kind were allowed in one case every professional office holder would claim to be entitled to deduct the payments made by him to every scientific society to which he happened to belong and the price which he paid for every professional publication, and there would be no end to it.'*

Lord Templeman said:

> *'Similarly in the present case it seems to me that a journalist does not purchase and read newspapers in the performance of his duties but for the purpose of ensuring that he will carry out his duties efficiently. If deductions of this kind were allowed in one case every journalist or other similar employee would claim to be entitled to deduct the payment made by him for every newspaper and periodical which he chose to purchase and there would be no end to it.'*

And at page 317E:

> *'No one doubts that a journalist may benefit from information and knowledge concerning past and present events and from former and contemporary examples of style and presentation. He may with profit read the past journalistic works of William Howard Russell, Bernard Shaw, Neville Cardus, and Henry Longhurst, amongst others. He may with profit read the contemporary leading articles of "The Times" or study the photographs in "The Star" or the headlines in "The Daily Mirror," or the layout of "The Daily Express." Before a journalist begins his daily work he must form a view of what he ought to be doing during the day. But he is not performing his duties when he prepares for work and there are a variety of ways in which he may choose to prepare and inform himself. The evidence in the present appeals largely ignored the help to be derived from Reuters, the Press Association and other news services and also the immediate help of radio and television broadcast. A journalist is free to choose his preparatory studies. It is said that some journalists best obtain ideas and keep up to date by wining and dining. The journalists in the present case chose to spend several hours every day reading a formidable mass of repetitive newsprint dealing with the events of yesterday. In my opinion, they were not, in the course of that reading, engaged in the performance of the duties for which they were paid.'*

He further said at page 318B-C:

> *'In all the cases there was but one question of law, namely whether upon the facts and upon the true construction of section 189 of the Act of 1970 the journalist incurred expense 'in the performance' of his duties when he selected, purchased and read newspapers and periodicals in his own time. If either set of commissioners failed to answer that question of law correct, the error of law must be corrected by the courts who are always entitled and bound to correct errors of law. In my opinion the Scottish commissioners reached the right conclusion of law and the English commissioners did not.'*

Lord Keith, Lord Jauncey of Tullichettle and Lord Mustill concurred in Lord Templeman's judgment.

16. Following the approach in **Fitzpatrick v IRC**, the question we ask ourselves is whether on the facts and upon the true construction of section 12(1)(a), the Taxpayer incurred expense in the performance of his duties when he incurred the expense or liability in purchasing the books for the students. The Taxpayer contended that it was part of his teaching duties to compile teaching materials and ensure that the necessary teaching materials reach the hands of the students. We are prepared to accept that it was part of his teaching duties to develop, review and redesign courses as well as to develop teaching materials. What we have difficulty in accepting is that he had any duty to undertake the purchase and sale of books. The evidence is in fact to the contrary. Dr C testified that other lecturers have not done what the Taxpayer had done. A lecturer can, as the Taxpayer himself in fact did in the previous year, use the facilities at the University to provide the

students with the teaching materials in the loosely-bound form. There was no necessity for the teaching materials to be disseminated in the form of a textbook, and undertaking by the Taxpayer in purchasing the books and reselling them to the students cannot be said to be necessary for the production of his income or the performance of his duties. Thus, while we find the Taxpayer's motive to be laudable and we have no doubt that he did what he did in the best interests of his students, we are unable to hold that his voluntary decision to purchase the books or the resultant loss that he incurred can be said to be 'necessarily incurred in the production of the assessable income'. For this reason, we must dismiss the appeal and confirm the assessment.