

**Commissioner of Inland Revenue**

*(Appellant)*

and

**Franco Tong Sui Lun**

*(Respondent)*

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**Court of First Instance**  
**(Inland Revenue Appeal No. 2 of 2006)**

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**Deputy High Court Judge Carlson**

**Date of Hearing : 11 December 2006**

**Date of Judgment : 20 December 2006**

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Inland Revenue Ordinance (Cap. 112) – Salaries Tax – deduction – undertaking to indemnify employer against all non-payments due to employer from clients handled or referred by a dealer representative taxpayer – whether incurred in the production of assessable income – whether necessarily incurred – amount deductible – whether excessive deduction could be reversed – section 12

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The taxpayer was a dealer's representative employed by a company stockbroker. He was required to observe the rules and regulations of his employer's dealer's manual, observe and perform his employer's directions and comply with laws, regulations and statutory instruments that regulated the conduct of the securities industry in Hong Kong. Parallel to these obligations, the taxpayer signed an indemnity agreement indemnifying his employer against all non-payments (settlement payment, interest, brokerage fee, commission, stamp duty, levy etc.) due to the employer from clients handled or referred by him.

A number of the taxpayer's clients had failed to settle their outstanding accounts with his employer. Pursuant to the indemnity agreement, the taxpayer entered into three agreements undertaking to pay the employer certain sums. The amounts stated in those three agreements were not the same as the amounts actually deducted by the employer from his emoluments. The taxpayer claimed deduction against his

assessable income those sums stated in the three agreements as “Bad Debts” and argued that any excessive deduction could be reversed in the next tax year.

The Board of Review decided that the “Bad Debts” were wholly, exclusively and necessarily incurred in the production of the assessable income. In addition, deduction was to be calculated in accordance with the three agreements.

The Commissioner appealed to the Court of First Instance.

**Held:**

- (1) What the law looked for in a Salaries Tax regime were expenses which were directly referable to the duty itself, the very tasks which the taxpayer was employed to do and not expenses which were personal to him arising from his contract of employment.
- (2) There was no doubt that the effect of “in the production of” in section 16 was different to that in section 12. What was deductible under section 16 was not necessarily so under the more restricted effect of the same words in section 12.
- (3) The two sides of the coin approach (assumption of risk going hand-in-hand with equal sharing of commission) of the Board sat entirely comfortably with a Profits Tax situation but it was completely alien to the Salaries Tax regime. The Board had failed to properly appreciate the very restrictive approach which the law required in a Salaries Tax assessment.
- (4) The taxpayer had failed to show that the expenditure was incurred in the performance of his duty.
- (5) The indemnity obligations were imposed by his contract, not by his duties in performing his employment. The expenditure was not necessarily incurred.
- (6) One needed to look at the moment of payment and the claim for relief would come in the tax year of that payment. This was reinforced by the fact that under Salaries Tax there was no mechanism for reversing a

previous assessment, as frequently happened under Profits Tax. One needed to be guided by the statute in this regard and where there was no provision for such reversals none was possible or permissible.

Appeal allowed.

Ms. Jennifer Tsui (instructed by the Department of Justice) for the Appellant  
Mr. Derek Chan (instructed by Messrs. Hui & Lam) for the Respondent

**Case referred to in the judgment:**

CIR v Humphrey (1970) 1 HKTC 451

Ricketts v Colquhoun [1926] AC 1

Humbles v Brooks (1962) 40 TC 500

CIR v Cosmotron Manufacturing Co. Ltd. [1997] HKLRD 1161 PC

Lomax v Newton (1953) 34 TC 558

Brown v Bullock (1961) 30 TC 1

D102/03 18 IRBRD 952