



Inland Revenue Department

The Government of the Hong Kong Special Administrative Region
of the People's Republic of China

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

NO. 9 (REVISED)

MAJOR DEDUCTIBLE ITEMS UNDER SALARIES TAX

These notes are issued for the information of taxpayers and their tax representatives. They contain the Department's interpretation and practices in relation to the laws as it stood at the date of publication. Taxpayers are reminded that their right of objection against the assessment and their right of appeal to the Commissioner, the Board of Review or the Court are not affected by the application of these notes.

These notes replace those issued in September 2002.

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MAJOR CATEGORIES OF ALLOWABLE DEDUCTIONS

A taxpayer may claim, among other things, the following allowable deductions for the purpose of computing his salaries tax liability –

- (a) all outgoings and expenses incurred in the production of his assessable income;
- (b) self-education expenses paid;
- (c) allowances calculated in accordance with Part VI of the Inland Revenue Ordinance (the Ordinance) in respect of capital expenditure on machinery or plant the use of which is essential to the production of his assessable income; and
- (d) approved charitable donations made.

HOW DEDUCTIONS ARE TO BE CLAIMED

2. The Tax Return-Individuals [B.I.R. 60] provides for entries to be made for claiming various deductions. Receipts need not be submitted with the completed return although they should be retained for eventual verification, if required by the Department. Since the onus of proving the validity of the deduction claim is on the taxpayer, it is in his own interest to keep full and contemporaneous records for all his claims.

OUTGOINGS AND EXPENSES

3. Section 12(1)(a) of the Ordinance provides that deductions may be claimed for –

“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”.

4. In order to be qualified for deduction, therefore, the expenditure must satisfy each of the following tests in addition to not being expenditure of a domestic or private nature or of a capital nature, e.g. expenditure to acquire an asset –

- (a) it must have been “incurred”;
- (b) it must have arisen “wholly and exclusively” in the production of the income; and
- (c) it must have been “necessary” in the production of the income.

“INCURRED”

5. The word “incurred” has been judicially considered on a number of occasions and the authorities are generally agreed that for an expenditure to have been incurred it must be an established liability or a definite commitment which arose in the year of assessment in which it is sought to be claimed as a deduction. Actual payment during the year in question is not necessary, but where payment has not been made before the end of that year, no deduction can be allowed unless there existed on the last day of that year an actual and known liability or obligation of *ascertainable amount*. A mere rough estimate, a contingent liability or an anticipated future outgoing will not therefore generally rank for deduction.

“WHOLLY” AND “EXCLUSIVELY”

6. These words are not to be considered too narrowly. Where expenditure is incurred for more than one purpose (e.g. running expenses of a car used partly for private purposes), such expenditure should be apportioned (usually on a mileage basis), and the part attributable to the employment would be allowed, provided the other tests are satisfied.

“NECESSARILY”

7. The word “necessarily” is to be construed as meaning essential to the conduct of the employment. It is not sufficient that the expenditure is related to the production of the income and possibly facilitates and aids the production of income. The basic test is whether the expenditure is vital to the employment to the extent that it would not be possible for the taxpayer to produce the income from the employment without incurring that expenditure. If the duties imposed by the employer require the expenditure to be incurred, one would expect that the employer will pay for such expenditure. Hence, it is hard for an employee to claim that he has paid for expenditure that his duties require him to incur, unless in the contract of employment the employee is required to bear the necessary expenses. However, it does not follow that because the employer has required the expenditure to be incurred by the employee that such expenditure is necessarily admissible: 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 that particular outlay”. [*Brown v. Bullock* 40 TC 1.]

“IN THE PRODUCTION OF THE ASSESSABLE INCOME”

8. The meaning of this phrase had been discussed in the Supreme Court case of *Commissioner of Inland Revenue v. Humphrey*, HKTC 451 together with the wording in similar provisions in the United Kingdom Income Tax Acts [“in the performance of the duties”] and the Australian Income Tax Assessment Act [“in gaining or producing the assessable income”]. The judgment in the Supreme Court was made on the basis that as far as the appeal in that case was concerned (a claim for travelling expenses from home to office) the difference in phraseology between the Taxing Acts, the Hong Kong provision having a certain affinity to the wording of the Australian Taxing Act, was immaterial.

9. Expenses are not incurred “in the performance of the duties” if they are incurred only to *enable* the duties to be performed e.g. travelling expenses between the taxpayer’s home and his place of employment; expenditures to acquire an employment or appointment; or the costs of memberships to social or sports clubs whether or not required by the employer. It is noteworthy that certain of the items mentioned also fail to qualify as allowable deductions under the other tests referred to in the preceding paragraphs.

10. Similarly, a distinction must be drawn between an expense incurred *in* gaining income and one incurred necessarily *for* the purpose of gaining it. This point was considered in the court case of *Commissioner of Inland Revenue v. Robert P. Burns, 1 HKTC 1181*, in which the Court rejected the claim for legal expenses incurred by a horse trainer in an appeal against disqualification: such expenses were merely incurred for the purpose of seeing that the claimant was not precluded from earning his assessable income and were therefore not incurred in the production of it.

11. Neither would sums paid upon termination of the employment contract by an employee, e.g. payment in lieu of notice, be admissible: they are not incurred in the production of income but are made in order to have the contract terminated and/or to avoid possible action for damages by the employer. [See *Board of Review Case No. BR 9/78.*]

EXPENSE ALLOWANCES FROM EMPLOYER

12. Allowances which are reasonable in amount and do no more than covering the employee's travelling, accommodation and related expenses incurred when he is working away from his usual base or place of residence as required by his employer would not be brought into charge as assessable income. However, any claim for expenses in excess of the employer's reimbursement would be expected to fail the test of "necessarily" incurred and would not be allowed. Moreover, a reimbursement from an employer for disallowable expenses incurred by an employee would be assessable.

SPECIFIC ITEMS OF EXPENDITURE

Clothing

13. The cost, if borne by the employee, of the replacement of special clothes required by the nature of the employment would be allowable (e.g. overalls). Otherwise, the test "wholly and exclusively" would not be expected to be complied with.

Commission-payment for services

14. Employees who are commission earners may need to pay commission to others in order to earn that income. Provided the conditions under section 12(1)(a) are satisfied, such payments are allowable deductions. It is important though that full information about the nature of the payment and the recipients should be provided to the Department.

Entertainment expenses

15. The claimant is expected to be able to show that any expenditure claimed was necessarily incurred and that it would not have been possible to have produced the income from the employment without incurring such expenditure. Mere social entertaining would be debarred as not being “wholly and exclusively incurred”. Any entertaining must be shown to have been necessarily incurred directly as part of business negotiations and records kept should not only give details of the cost and the names of the persons entertained but the nature of the business in question. It goes without saying that the excess of any round sum entertainment allowance over admissible entertainment expenses incurred is assessable as income from an office or employment.

Payments to assistants

16. In general, such expenses would not be “necessarily” incurred. However, in case, for example, an employee is remunerated on a commission basis, a claim for such payments would be admitted provided that the necessity can clearly be shown for the need of assistance in the light of the volume of business transacted and the amounts paid can also be regarded as reasonable for the work done.

Subscriptions to professional societies etc.

17. Although it is considered that subscriptions to professional societies etc. are in general not allowable under a strict interpretation of the wording of the Ordinance, in practice an allowance is admitted where the holding of a professional qualification is a prerequisite of employment and where the retention of membership and the keeping abreast of current developments in

the particular profession are of regular use and benefit in the performance of the duties. Any such allowance is to be restricted to the subscription to one professional association. [See *Board of Review Case No. BR 19/73.*] Subscriptions and fees paid to Trade Unions would not qualify.

Travelling expenses

18. Reasonable expenses of travel from one place of employment to another would be admitted, while expenses of travel from home to office are not. Allowable expenses are restricted to those necessarily incurred in the performance of duties. If for example motor car expenses are claimed, regard would be had as to whether the amount claimed is reasonable having regard to the availability of public transport and taxis.

19. If the nature of the employment is such that the use of a car is necessary to the carrying out of the duties, the claim should include information as to the basis on which the employer reimburses expenditure incurred, and the extent to which the car is used for purposes other than for the employment. The cost of repairs and running expenses would be apportioned as between private use and use for the employment.

ALLOWANCES FOR CAPITAL EXPENDITURE

20. Under section 12(1)(b) of the Ordinance, “allowances calculated in accordance with Part VI in respect of capital expenditure on machinery or plant the use of which is essential to the production of the assessable income” are deductible. Information as to the calculation of allowances under this provision is contained in Departmental Interpretation and Practice Notes No. 7 (Revised).

21. Claims under this provision would not arise other than in an employment in which the employer does not reimburse the employee for the use of the machinery or plant (the most common example would be a motor car) and where the employee can show that the use of the plant or machinery is essential to the performance of the duties giving rise to the assessable income.

SELF-EDUCATION EXPENSES

22. Commencing from 1 April 1996, a taxpayer can claim under section 12(1)(e) of the Ordinance for a deduction of self-education expenses he paid. From year of assessment 2000/01 onwards, expenses of self-education are defined to include fees, including tuition and examination fees, in connection with a prescribed course of education, fees of examination set by an education provider, or trade, professional or business association.

23. A prescribed course of education is one undertaken at specified education providers. Specified education providers include universities, technical colleges, schools registered under the Education Ordinance, and any other institutions approved by the Commissioner. For details of the approved institutions, please visit the Department's homepage at www.ird.gov.hk. A prescribed course of education also includes a training or development course provided by a trade, professional or business association. From the year of assessment 2004/05 onwards, the term also includes a training or development course accredited or recognized by certain professional bodies, institutions, associations that are specified in Schedule 13 of the Ordinance.

24. The course of education or the examination undertaken must be for gaining or maintaining qualifications for use in any employment. General interest classes, for example, a Tai Chi course, will not qualify as an employment-related course unless say, a Tai chi instructor employment is contemplated.

25. Fees that have been reimbursed or are reimbursable by an employer or any other person are not allowable. The deduction is allowed in the year of assessment in which the expenses were paid; the period covered by the courses is irrelevant. The total amount of self-education expenses that may be deducted in any year of assessment shall not exceed the amount specified in relation to that year in Schedule 3A of the Ordinance. From year of assessment 2001/02 onwards, the maximum amount that can be claimed is \$40,000.

CONCESSIONARY DEDUCTIONS UNDER PART IVA

26. Section 12B(1)(a) provides that in ascertaining the net chargeable income of a person, the deductions under Part IVA comprising approved charitable donations, elderly residential care expenses, home loan interest and contributions to recognized retirement schemes shall be allowed whenever appropriate.

Approved Charitable Donations

27. Section 26C(1) of the Ordinance provides that where a person or his/her spouse, not being a spouse living apart from the person, makes any approved charitable donations during any year of assessment, a deduction in respect of the aggregate amount of the approved charitable donations shall be allowable to the person for that year of assessment provided that the aggregated amount is not less than \$100.

28. If the person is chargeable to salaries tax, no deduction shall be allowable to him/her in respect of –

- (a) any sum which is allowable under profits tax; and
- (b) any sum by which the aggregated amount of the approved charitable donations is in excess of 25%¹ of his/her assessable income for that year as reduced by the deductions provided under section 12(1)(a) and (b) for that year of assessment. If the person and his/her spouse have elected joint-assessment under section 10(2) of the Ordinance, then the deduction limit is set at 25%¹ of the aggregate of assessable income as reduced by deductions under section 12(1)(a) and (b).

29. Where a person has made an election for personal assessment under section 41 in any year of assessment, no deduction shall be allowable to that person for that year of assessment in respect of any approved charitable donation –

¹ 25% is for any year of assessment commencing on or after 1 April 2003. For any year of assessment up to and including the year of assessment commencing 1 April 2002, the percentage is 10%.

- (a) which is allowable as deduction under profits tax;
- (b) which has been allowed as a deduction to his/her spouse against the total income of that spouse that is required to be aggregated under section 42A(1);
- (c) which, when aggregated with any sum that is allowable as a deduction under section 16D for that year of assessment, is in excess of 25%¹ of the total amount of –
 - (i) the total income of that person for that year of assessment;
 - (ii) approved charitable donations which is allowable as a deduction under section 16D; and
 - (iii) self-education expenses which is allowable as a deduction under section 12(1)(e).

30. Where there are more than one claimants for the same donation, unless agreement is reached amongst themselves, no allowance for the contentious donation will be granted.

31. Fuller details on the deduction for approved charitable donations are set out in the Departmental Interpretation and Practice Notes No. 37.

Elderly Residential Care Expenses

32. With effect from the year of assessment 1998/99, a person may claim a deduction for elderly residential care expenses paid by the person or his/her spouse to a residential care home in respect of his/her or his/her spouse's parent or grandparent under salaries tax and personal assessment. A person chargeable to tax at standard rate is also entitled to the deduction.

33. The following conditions must be satisfied before the deduction is granted –

- (a) the parent/grandparent is aged 60 or above at any time in the year of assessment, or under 60 but entitled to claim an allowance under the Government's Disability Allowance Scheme; and
- (b) the residential care home is licensed or exempted from licensing under the Residential Care Homes (Elderly Persons) Ordinance, or is a nursing home registered under the Hospitals, Nursing Homes and Maternity Homes Registration Ordinance.

34. The deduction is allowed for the expenses actually paid to a residential care home in respect of residential care received, subject to a maximum of \$60,000 for a year of assessment for each parent or grandparent.

35. The deduction is allowed in respect of a parent/grandparent to only one claimant for a year of assessment. Should the deduction be allowed to a person, he or any other person is not entitled to claim dependent parent/grandparent allowance and additional parent/grandparent allowance for the same parent/grandparent for the same year of assessment.

36. For the purpose of processing the claim, the Assessor may ask the claimant to produce the following information and documents –

- (a) particulars of the parent/grandparent, i.e. name, Hong Kong identity card number, date of birth and if aged under 60, reference number under the Government's Disability Allowance Scheme;
- (b) the name and address of the residential care home; and
- (c) the amount paid and receipt(s) issued by the residential care home or other documentary evidence for the payment.

37. Fuller details on the deduction for elderly residential care expenses are set out in the Departmental Interpretation and Practice Notes No. 36.

Home Loan Interest

38. With effect from the year of assessment 1998/99, home loan interest paid is deductible under section 26E of the Ordinance from a person's assessable income under salaries tax or from a person's total income under personal assessment. A person chargeable to tax at standard rate is also entitled to the deduction.

39. For the purposes of processing the claim, the Assessor may ask the claimant to produce the following documents –

- (a) proof of ownership of the dwelling;
- (b) proof of dwelling being used as his place of residence;
- (c) loan agreement or mortgage deed; and
- (d) receipts for repayment of loan.

40. Fuller details on the deduction for home loan interest are set out in the Departmental Interpretation and Practice Notes No. 35.

Contribution to Recognized Retirement Schemes

Mandatory Provident Fund Scheme (MPFS)

41. With effect from 1 December 2000, employees (full-time or part-time) and self-employed persons, except the exempt persons under the MPFS Ordinance, are required to participate in a MPFS. For employees or self-employed persons earning over \$4,000 per month, the mandatory contribution is 5% of the person's income. The maximum contribution is \$1,000 per month or \$12,000 per year. Insofar as salaries tax is concerned, section 26G(3)(b) provides for deduction of the amount of mandatory contributions paid by a person as an employee during a year of assessment, to the extent of the amount specified in Schedule 3B.

Recognized Occupational Retirement Schemes (RORS)

42. Where a person, as an employee, opts to participate in a MPF-exempted RORS instead of joining a MPFS, the amount of deduction allowable under section 26G(3)(a) is the lesser of –

- (i) the amount of the contributions paid by the person to the RORS; and
- (ii) the amount of the mandatory contributions that the person would have been required to pay had that scheme been a MPFS.

The amount of the deduction cannot exceed the amount specified in Schedule 3B.

FALSE CLAIMS

43. The wilful submission of an incorrect return or the making of a false statement in connection with a claim for any deduction or allowance by a person, renders the person (or any person who has assisted the person to evade tax) liable to a fine on summary conviction at level 3 (i.e. \$10,000 at current level) and a further fine of treble the amount of tax which has been undercharged in consequence of the offence or which would have been undercharged if the offence had not been detected, and to imprisonment for six months, and on indictment to a fine at level 5 (i.e. \$50,000 at current level) and a further fine of treble the amount of tax so undercharged or which would have been so undercharged and to imprisonment for three years.