



Inland Revenue Department
Hong Kong

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

NO. 12 (REVISED)

COMMISSION, REBATES AND DISCOUNTS

These notes are issued for the information and guidance of taxpayers and their authorised representatives. They have no binding force and do not affect a person's right of objection and appeal to the Commissioner, the Board of Review or the Courts.

These notes replace those issued in June 1976.

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Commissioner of Inland Revenue

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INTRODUCTION

Section 16(1) of the Inland Revenue Ordinance provides that outgoings and expenses incurred in the production of assessable profits are deductible for profits tax purposes. Commissions, rebates and discounts will qualify for deduction if they satisfy this condition. This Practice Note sets out the disclosure requirements in respect of these outgoings and expenses and the action the Department will take in the absence of sufficient documentary evidence to support any such deduction claimed.

FIELD AUDIT FINDINGS

2. The Department has been conducting field audits on selected tax returns since 1991. In the course of these audits, the following irregularities in relation to commissions have been spotted in some cases:

- (a) the recipient of the commission was a closely connected non-resident and yet this fact was not properly reflected in the profits tax return under the part for transaction with non-resident;
- (b) some commission payments were grouped with the purchase cost of goods resulting in no or a smaller commission expense figure in the profit and loss accounts; and
- (c) unsubstantiated commission payments were charged in accounts.

In all of these cases, the Assessors found the payments unjustified and issued assessments disallowing the payments and instituted penal actions subsequently.

3. It is clear from these findings that certain auditors have failed to use proper audit procedures to detect what can at best be described as failures to distinguish these payments in the accounts and tax computations, or at worst, deliberate attempts to mislead the Revenue by misdescribing the payments or making unsubstantiated claims. The Department takes a serious view on these instances and penal action under the Ordinance will, almost invariably, be instituted against those people who have made the unjustified claims.

DISCLOSURE RULES

4. In order to ascertain the deductibility of commissions, rebates and discounts made by the taxpayer, it is necessary for the following disclosure requirements to be met, when filing profits tax returns:

- (a) instead of showing the income net of commissions, rebates and discounts, taxpayers should return the gross income and clearly distinguish the payment of commissions, rebates and discounts in the accounts and tax computations submitted in support of profits tax returns;
- (b) the following information should be disclosed for each payment:
 - (i) full name, address and identity card number or business registration number of the recipient;
 - (ii) whether the recipient has any relationship with the taxpayer;
 - (iii) amount of the payment;
 - (iv) details of services rendered; and preferably
 - (v) evidence of payment.

5. The only exceptions to the disclosure rule mentioned in 4(a) above are:

- (a) commissions, rebates and discounts allowed in the ordinary course of trade on a principal to principal basis where it is expected that such commissions, rebates or discounts would be reflected in the accounts of each party to the transaction;
- (b) commissions, rebates and discounts paid to any individual who is an employee or otherwise of either principal and the separate amounts are disclosed under the name and address of the recipient on the statutory BIR Form No.56A (employer's return).

THE ARRANGEMENT

6. Where the taxpayer is unable or unwilling to disclose the names and addresses of the recipients, the amounts paid by way of commissions, rebates and discounts should be disallowed in the tax computations. This arrangement is accepted as a compromise to the business concerned and it does not relieve the recipient of these payments from his responsibility to return the amount for tax purposes.

7. However, this arrangement is not acceptable to the Department in the following circumstances:

- (a) the payer suffers an overall operating loss in the basis period in which the commissions, etc., were incurred;
- (b) the expenses were incurred in part of an accounting period which does not fall into a basis period and will consequently drop out for assessment purposes; or
- (c) these expenses were incurred in respect of a capital transaction and would not have been allowable as a deduction in the first place.

In each of the above scenarios, the payer will either be assessed as agent of the recipients of commissions, etc., or he should disclose the information as stated in paragraph 4(b) for direct assessments to be raised on the recipients. Failure of the payer to disclose such information would be followed by action under section 51(4)(a) of the Ordinance.

CONCEALED COMMISSION, REBATE AND DISCOUNT PAYMENTS

8. Where taxpayers have made commission, rebate and discount payments without proper disclosure and caused loss to the revenue, they are advised to take advantage of the statement of practice relating to voluntary disclosure contained in Departmental Interpretation & Practice Notes No. 11 (Elements of Tax Investigation). Taxpayers who do not would run a grave risk of prosecution under the Inland Revenue Ordinance when, as a result of

Departmental enquiries, evidence of concealed commissions is obtained. In addition, the auditor responsible may also be liable to prosecution under sections 80 and 82 of the Ordinance.