

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D131/00

Salaries tax – whether gratuity.

Panel: Kenneth Kwok Hing Wai SC (chairman), David Li Ka Fai and Lily Yew.

Date of hearing: 2 February 2001.

Date of decision: 27 February 2001.

The taxpayer was employed as an assistant engineer. The terms of his employment contain a gratuity clause, that is, 25% gratuity on basic salaries upon satisfactory completion of the full period of his employment. His employment was extended twice. Subsequently, he was paid \$390,740 as gratuity (‘ the 25% Payment’).

The taxpayer contended that the 25% Payment was a severance payment and thus not taxable.

Held:

1. The extensions of his employment could not be construed as dismissal.
2. Furthermore, the 25% Payment was payable only upon satisfactory completion of the employment irrespective of whether he was dismissed or further employed.

Appeal dismissed and a cost of \$5,000 charged.

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Leung Wing Chi for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

1. This is an appeal against the determination of the Commissioner of Inland Revenue dated 17 November 2000, confirming the following assessments:

- (a) additional salaries tax assessment for the year of assessment 1996/97 under charge number 9-2330120-97-8, dated 24 August 1999, showing net additional assessable income of \$71,243 with tax payable thereon of \$10,686;
- (b) second additional salaries tax assessment for the year of assessment 1997/98 under charge number 9-3670664-98-3, dated 24 August 1999, showing net additional chargeable income of \$214,907 with tax payable thereon of \$29,013 [after giving effect to Tax Exemption (1997 Tax Year) Order]; and
- (c) salaries tax assessment for the year of assessment 1998/99 under charge number 9-0587461-99-7, dated 24 August 1999, showing net chargeable income of \$979,811 with tax payable thereon of \$156,067.

The admitted facts

2. The following facts are agreed by the Taxpayer and we find them as facts.
3. By a letter dated 24 April 1981, a company called A & Company Limited employed the Taxpayer as its assistant engineer with effect from 4 May 1981.
4. On various dates, A & Partners, acting as agents for the Government of Hong Kong, entered into the following local resident staff agreements with the Taxpayer:

Date of the agreement	Duration of the agreement
1-6-1983	1-6-1983 to 30-11-1985
1-12-1985	1-12-1985 to 31-5-1988 (This contract was further extended to 31-5-1989)
1-6-1989	1-6-1989 to 30-11-1991
1-12-1991	1-12-1991 to 30-5-1994
1-6-1994	1-6-1994 to 30-11-1996

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5. By a letter dated 29 November 1996, A (Hong Kong) Ltd (‘ the Employer’) offered to employ the Taxpayer as its resident engineer for a period of two years covering the period from 1 December 1996 to [30] November 1998 (‘ the Agreement’). The terms of employment were governed by the conditions of service for direct employment, which contain, among other things, the following clause in respect of gratuity:

‘ 25% gratuity on basic salaries will be payable on satisfactory completion of the full period of the agreement.’

6. By a letter dated 30 May 1997, the Employer indicated to the Taxpayer that its name was changed to B (Hong Kong) Limited.

7. By letters dated 20 August 1998 and 24 March 1999, the Employer informed the Taxpayer that the employment agreement in paragraph 5 above would be extended up to 31 March 1999 and further to 31 May 1999 respectively.

8. In February 1999, the Employer, pursuant to the Agreement, paid to the Taxpayer a sum denoted as gratuity in the amount of \$390,740 (‘ the 25% Payment’) which was equal to 25% of the Taxpayer’s total salaries for the period from 1 December 1996 to 30 November 1998.

9. The Employer ceased to employ the Taxpayer with effect from 1 June 1999.

10. In his tax return for the year of assessment 1996/97, the Taxpayer declared that he was provided quarters by the Employer to whom he had paid rent of \$34,309. The Taxpayer also claimed deduction of a subscription fee of \$1,140 and declared the following particulars of income from the Employer:

	\$
Salaries	708,960
Gratuities in respect of the period from 1 June 1994 to 30 November 1996	379,722
Back pay	12,020
Travel allowance	176
Leave pay	<u>231,120</u>
	<u>1,331,998</u>

The Taxpayer also applied for the relating back of the gratuities and leave pay.

11. As the Taxpayer would have to pay more tax if the gratuities or leave pay were related back, the assessor did not relate back the gratuities and leave pay. He raised on the Taxpayer the following salaries tax assessment for the year of assessment 1996/97:

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	\$
Income as per paragraph 10	1,331,998
<u>Add:</u> Rental value	
[(\$1,331,998 - \$1,140) x 10% - \$34,309]	<u>98,776</u>
Assessable income	1,430,774
<u>Less:</u> Professional subscription	<u>1,140</u>
Net assessable income	<u><u>1,429,634</u></u>
Tax payable thereon	<u><u>214,445</u></u>

No objection has been lodged against this assessment.

12. In his tax return for the year of assessment 1997/98, the Taxpayer claimed for deduction of charitable donation of \$100 and a subscription fee of \$1,280. He also declared that he was provided quarters by the Employer from whom he had received the following amount of income:

	\$
Salary	988,062
Gratuities	86,670
One-off payment	<u>1,467</u>
	<u><u>1,076,199</u></u>

13. On various dates, the assessor raised on the Taxpayer the following salaries tax assessments:

	\$
(a) <u>Year of assessment 1997/98</u>	
Assessable income as per paragraph 12	1,076,199
<u>Less:</u> Charitable donation	100
Professional subscription	<u>1,280</u>
Net chargeable income	<u><u>1,074,819</u></u>
Tax payable thereon	<u><u>161,222</u></u>
	\$
(b) <u>Year of assessment 1997/98 (additional)</u>	
Assessable income as per above	1,076,199
<u>Add:</u> Rental value	
[(\$1,076,199 - \$1,280) x 10%]	<u>107,491</u>
	1,183,690
<u>Less:</u> Charitable donation	100
Professional subscription	<u>1,280</u>
Net chargeable income	1,182,310
<u>Less:</u> Net chargeable income previously	

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assessed	1,074,819
Net additional chargeable income	107,491
Tax payable thereon	16,124

No objection has been lodged against the original and additional assessments for the year of assessment 1997/98.

14. To give effect to the Tax Exemption (1997 Tax Year) Order, the tax payable for the year of assessment 1997/98 was reduced by 10% to \$159,611.

15. In his tax return for the year of assessment 1998/99, the Taxpayer claimed for deduction of subscription fee of \$1,283 and charitable donation of \$100. He also applied for dependant parent allowance and additional dependant parent allowance in respect of his parents. Further, he declared that he was provided quarters by the Employer from whom he had received the following amount of income:

(a)	Salaries	\$968,780
(b)	25% Payment for the period 1-12-1996 to 30-11-1998	\$390,740

The Taxpayer also applied to relate back the 25% Payment pursuant to section 11D(b) proviso (i) of the Inland Revenue Ordinance (‘IRO’).

16. The assessor accepted that the 25% Payment could be related back for the period from 1 December 1996 to 30 November 1998. He raised on the Taxpayer the following assessments:

(a)	<u>Year of assessment 1996/97 (additional)</u>	\$
	Income as per paragraph 10	1,331,998
	<u>Add:</u> 25% Payment related back	
	[\$390,740 x $\frac{121 \text{ days}}{730 \text{ days}}$]	64,766
	Rental value	
	[\$98,776 + \$64,766 x 10%, see paragraph 11]	105,253
	Assessable income	1,502,017
	<u>Less:</u> Professional subscription	1,140
	Net assessable income	1,500,877
	<u>Less:</u> Net assessable income previously	

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assessed		1,429,634
Net additional assessable income		<u>71,243</u>
Tax payable thereon		<u>10,686</u>
 (b) <u>Year of assessment 1997/98 (second additional)</u>		
		\$
Income as per paragraph 12		1,076,199
<u>Add:</u> 25% Payment related back		
	$\$390,740 \times \frac{365 \text{ days}}{730 \text{ days}}$	195,370
Rental value	[\$107,491 + \$195,370 x 10%, see paragraph 13(b)]	<u>127,028</u>
Assessable income		1,398,597
<u>Less:</u> Charitable donation		100
Professional subscription		<u>1,280</u>
Net chargeable income		1,397,217
<u>Less:</u> Net chargeable income previously assessed		<u>1,182,310</u>
Net additional chargeable income		<u>214,907</u>
Tax payable thereon [after giving effect to Tax Exemption (1997 Tax Year) Order]		<u>29,013</u>
 (c) <u>Year of assessment 1998/99</u>		
		\$
Income as per paragraph 15(a)		968,780
<u>Add:</u> 25% Payment related back		
	$[\$390,740 \times \frac{244 \text{ days}}{730 \text{ days}}]$	130,604
Rental value	[(\\$968,780 + \$130,604 - \$1,283) x 10%]	<u>109,810</u>
Assessable income		1,209,194
		\$
<u>Less:</u> Charitable donation		100
Professional subscription		1,283
Basic allowance		108,000
Dependant parent allowance and additional dependant parent allowance		<u>120,000</u>
Net chargeable income		<u>979,811</u>

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Tax payable thereon

156,067

17. The Taxpayer objected against the assessments set out at paragraph 16 on the ground that the 25% Payment was a severance payment made pursuant to the Employment Ordinance (Chapter 57) (‘EO’) and that the 25% Payment was not payment for services rendered.

The Taxpayer’s contention

18. The Commissioner rejected the Taxpayer’s objection. The Taxpayer appealed on the same ground contending that the 25% Payment was a severance payment and was not payment for services rendered.

Our decision

19. In our decision, the Taxpayer’s contention is obviously unsustainable.

No dismissal during the year of assessment 1998/99

20. To start with, there is absolutely no factual basis for the contention.

21. The Taxpayer had never been dismissed in the year of assessment 1998/99. As stated in paragraph 5 above, the Taxpayer’s employment under the letter dated 29 November 1996 was from 1 December 1996 to 30 November 1998. As stated in paragraph 8 above, the 25% Payment was 25% of the Taxpayer’s total salary for the period from 1 December 1996 to 30 November 1998 and was paid to the Taxpayer in February 1999. As stated in paragraph 7 above, his employment was **extended to 31 March 1999** by letter dated 20 August 1998 and **further extended to 31 May 1999** by letter dated 24 March 1999. As stated in paragraph 9 above, the Taxpayer’s employment by the Employer did not cease until 1 June 1999.

22. Section 31D(2) of the EO provides that:

‘ An employee shall not be taken for the purposes of this Part to be dismissed by his employer if –

- (a) his contract of employment is renewed, or he is re-engaged by the same employer under a new contract of employment; and*
- (b) the renewal or re-engagement takes effect immediately on the ending of this employment under the previous contract.’*

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By section 2(1), 'renewal' includes 'extension, and any reference to renewing a contract shall be construed accordingly'.

23. The Taxpayer had been employed throughout the year of assessment 1998/99 and had not been dismissed and is not deemed to be dismissed in the year of assessment 1998/99. The Employer had no arguable liability to pay severance payment in the year of assessment 1998/99. The contention that the 25% Payment which was 25% of his total salary from 1 December 1996 to 30 November 1998 and paid to him in February 1999 was severance payment is clearly unarguable.

24. This ground is by itself fatal against the Taxpayer and the appeal is bound to fail and fails.

Chargeable income

25. Further and in any event, it is clear from the provision on the 25% Payment quoted in paragraph 5 above that the 25% Payment was payable 'on satisfactory completion of the full period of the agreement'. On satisfactory completion of the full period, the Employer was liable for the 25% Payment in any event - irrespective of whether or not the Taxpayer had been dismissed by his employer, irrespective of whether or not the Taxpayer was deemed to have been dismissed by his employer, irrespective of whether or not there was a redundancy, irrespective of whether or not there was a deemed redundancy, and even if the Employer continued to employ him under a new contract on the same or better terms, and despite the fact the Employer had renewed the Taxpayer's employment. The 25% Payment was earned by the Taxpayer on satisfactory completion of the full period of the agreement and is chargeable income by reason of sections 8(1) and 9(1)(a) of the IRO.

26. This is another reason why the Taxpayer's contention is obviously unsustainable and is bound to fail and fails.

The 29 June 2000 letter

27. The Taxpayer contended that we should deal with this appeal together with his request in the letter dated 29 June 2000 to the Commissioner by which he contended that 'the gratuities of \$106,860 as filled in the assessment of salaries tax 1999/2000 are actually part of the severance payment from my ex-employer' and requested the Commissioner 'to exclude the aforesaid gratuities from my salaries tax assessment 1999/2000 accordingly'.

28. It is a contention which the Taxpayer made without doing any home work.

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29. The request was to exclude \$106,860 from the assessment for the year of assessment 1999/2000 which suggests that no assessment for the year of assessment 1999/2000 had yet been issued. There must be an assessment before there could be an objection to the Commissioner under section 64 of the IRO, and there must be a determination by the Commissioner before there could be an appeal to the Board of Review under section 66.

30. The Taxpayer has not placed the assessment for the year of assessment 1999/2000 before us, not to mention any objection by him, or any determination by the Commissioner. In this appeal we are only concerned with the assessments confirmed by the Commissioner and referred to in paragraph 1 above.

Disposition

31. The Taxpayer has not discharged the onus under section 68(4) of the IRO. We dismiss the appeal and confirm the assessments as confirmed by the Commissioner.

Costs order

32. As noted in a number of Board decisions, the discretion of the Board under section 68(9) of the IRO to order an unsuccessful appellant to pay costs is not expressed to be restricted to appeals which are obviously unsustainable. The maximum sum was increased from \$100 to \$1,000 in 1985 and further increased to \$5,000 in 1993. \$5,000 represents only a small fraction of the costs of the Board in disposing of an appeal.

33. In this case, the Taxpayer put forward the severance payment contention in an attempt to get his way out of his duty to pay salaries tax on his income of \$390,740. For reasons we have given, this contention is frivolous and vexatious. In our Decision, this appeal is an abuse of the process. Pursuant to section 68(9) of the IRO, we order the Taxpayer to pay the sum of \$5,000 as costs of the Board, which \$5,000 shall be added to the tax charged and recovered therewith.

Postscript

34. Lastly, we would like to thank Miss LEUNG Wing-chi for her able and helpful assistance.