

Case No. D16/06

Salaries tax – whether or not the gratuity was remuneration and reward paid to the taxpayer under the contract of employment – section 2 of Employment Ordinance ('EO') – section 9(1) of the Inland Revenue Ordinance ('IRO')

Panel: Patrick Fung Pak Tung SC (chairman), Lawrence Lai Wai Chung and Carlson Tong.

Date of hearing: 20 January 2006.

Date of decision: 3 May 2006.

The taxpayer was employed by Company B by a Contract. There was a clause in the Contract to provide the payment of gratuity. Upon completion of the Contract, the taxpayer ceased employment with Company B. Company B has offered two further three months extension of the taxpayer's employment under the Contract and the taxpayer accepted. The case of the taxpayer is that the sum of money was a gratuity payable by his employer on the termination of his contract of employment; it was a 'severance payment' under the EO and should be exempt from salaries tax. The case of the Commissioner is that the said sum was part of the remuneration and reward paid to the taxpayer under his contract of employment and should not be exempt from Salaries Tax.

Held:

1. It is settled law that labels such as 'gratuity' or 'severance payment' in contracts of employment are not conclusive. One must look at the terms of the contract in question and the character of a payment made under it in order to determine the true nature of such payment.
2. On the evidence before the Board, the Board is no doubt that the said sum was part of the remuneration paid to the taxpayer in accordance with the Contract and not a 'severance payment' within the meaning of section 2 of the EO. The same falls squarely within the meaning of 'gratuity' and 'perquisite' in section 9(1) of the IRO (D131/00, IRBRD, vol 16, 1; D151/00, IRBRD, vol 16, 101; D51/01, IRBRD, vol 16, 451; D81/01, IRBRD, vol 16, 671; D110/03, IRBRD, vol 19, 44 and D10/04, IRBRD, vol 19, 116 considered).

Appeal dismissed.

Cases referred to:

D131/00, IRBRD, vol 16, 1
D151/00, IRBRD, vol 16, 101
D51/01, IRBRD, vol 16, 451
D81/01, IRBRD, vol 16, 671
D110/03, IRBRD, vol 19, 44
D10/04, IRBRD, vol 19, 116

Taxpayer in person.

Wong Siu Suk Han and Ng Yuk Chun for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal by the Appellant ('the Taxpayer') against the Determination by the Respondent ('the Commissioner') dated 1 September 2005 ('the Determination') whereby the Commissioner acting by one of her deputies rejected the objection lodged by the Taxpayer against an assessment and demand for salaries tax for the year of assessment 2003/04 raised on him.

The Facts

2. At the hearing of the appeal, the Taxpayer was asked by the Board whether he agreed with the facts as set out in the Determination. His answer was in the affirmative. In the circumstances and for the sake of convenience, we set out the facts as set out in sub-paragraphs (2) – (11) of paragraph 1 in the Determination as follows:

- ' (2) The Taxpayer had been employed by [Company A] since 11 August 1997 and was transferred to [Company B] on 1 July 1999.
- (3) (a) By a letter dated 19 October 2001 [Company B] offered to renew the Taxpayer's appointment as Resident Engineer for a term of 24 months commencing on 24 September 2001 ['the Contract' at Appendix A]. Clause 3 of the Contract provided for the payment of gratuity in the following terms :

“3. Gratuity

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On satisfactory completion of the full term of engagement, or if we determine your engagement when necessitated by work on site and for reasons other than misconduct, you will be paid a gratuity of 15% of the total basic salary paid during the engagement period up to a date immediately before section 7A of the Mandatory Provident Fund (MPF) Scheme Ordinance (Cap. 485), as amended by the Provident Fund Schemes Legislation (Amendment Ordinance) 1998 (“Amendment Ordinance”), comes into effect, or the end of this agreement, whichever is earlier.

Starting from the commencement date of section 7A of the Mandatory Provident Fund (MPF) Ordinance as amended by the Amendment Ordinance, the Company will make a monthly contribution in respect of you to a scheme registered under the MPF Schemes Ordinance for the remainder of this agreement at the statutory contribution rate (i.e. 5% of your monthly relevant income or \$1,000 whichever is the less).

The gratuity payable for the remainder of this agreement will be the sum which, when added to the Company’s contribution to the said MPF scheme, equals to 15% of the total basic salary drawn during that period.”

The Taxpayer accepted the offer on 10 November 2001.

- (b) By a letter dated 29 August 2003 [Company B] offered to extend the Taxpayer’s employment under the Contract for 3 months up to 23 December 2003. The Taxpayer accepted the offer on 5 September 2003.
 - (c) By a letter dated 17 November 2003, [Company B] offered to extend the Taxpayer’s employment under the Contract for a further 3 months up to 23 March 2004. The Taxpayer accepted the offer on 26 November 2003.
 - (d) By a letter dated 2 March 2004, [Company B] offered to extend the Taxpayer’s employment under the Contract for another 2 months up to 23 May 2004. The Taxpayer accepted the offer on 11 March 2004.
- (4) Upon completion of the Contract on 23 May 2004 [Fact (3) (d)], the Taxpayer ceased employment with [Company B].

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- (5) [Company B] filed an Employer's Return of Remuneration and Pensions for the year ended 31 March 2004 in respect of the Taxpayer showing the following income particulars :

Salary	\$600,000
Gratuities	194,814
Total :	<u><u>\$794,814</u></u>

- (6) The gratuities of \$194,814 [Fact (5)] are analysed as follows :

Period of Engagement	Gratuity paid
24 Sep 2001 to 23 Sep 2003 [Fact (3)(a)]	\$156,000
24 Sep 2003 to 23 Dec 2003 [Fact (3)(b)]	19,314
24 Dec 2003 to 23 Mar 2004 [Fact (3)(c)]	19,500
Total :	<u><u>\$194,814</u></u>

Copies of the calculation sheets in respect of the gratuities of \$194,814 are at Appendix B.

- (7) In his Tax Return for the year of assessment 2003/04, the Taxpayer declared the following particulars that were relevant to ascertaining his Salaries Tax liabilities :

- (a) Income accrued to him during the year :

Name of Employer	Capacity employed	Period	Total amount (\$)
[Company B]	RESIDENT ENGINEER	1 April 2003 to 31 March 2004	600,000
	(UNEMPLOYED FROM APRIL 04)		
Grant total \$			600,000

- (b) Deductions :

- (i) Expenses of self-education paid to specified institution for prescribed course \$3,500
- (ii) Mandatory contribution to recognized retirement schemes in the capacity of an employee \$24,000

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(c) Child allowance :

(i) Name	[Miss C]	[Miss D]
(ii) Date of birth	26.05.1981	26.06.1991
(iii) The dependant was of or over 18 but under 25 years of age and received full-time education at any time during the year.	Yes	Not applicable

(8) The Assessor raised on the Taxpayer the following 2003/04 Salaries Tax Assessment :

Self Income [Fact (5)]		\$794,814
<u>Less</u> : Self Education Expenses	\$3,500	
Contribution to Recognized Retirement Schemes	<u>12,000</u>	<u>15,500</u>
		779,314
<u>Less</u> : Basic Allowance	\$104,000	
Child Allowance	<u>60,000</u>	<u>164,000</u>
Net Chargeable Income		<u><u>\$615,314</u></u>
Tax Payable thereon		<u><u>\$103,108</u></u>

(9) The Taxpayer objected to the above assessment in the following terms :

“Please be informed that my salary income from 1/4/2003 – 31/3/2004 is \$600,000. The remaining \$194,814 is awards of cessation of my employment with [Company B]. Please kindly revise your assessment of 2003/04 accordingly.”

(10) In a letter dated 27 August 2004, the Taxpayer stated, “The terminal award of \$194,814 was paid for termination of employment by [Company B] owing to shortage of construction works in HK. The fact is that I am no longer employed by [Company B] and is unemployed at the present moment.”

(11) In pursuance of his objection to the 2003/04 Salaries Tax Assessment, the Taxpayer stated that :

“... I am afraid I cannot accept conclusion made by the Board Of Review Decision [D131/00, 16 IRBRD1] and I wish to pursue my objection further for your further consideration.

The gratuities of \$194,814 I received from [Company B] in the year of assessment 2003/04 was on satisfactory completion of my employment contract in ‘Senion (sic) Residence Of The [XXXX]’ and the contract was extended to 23 May 2004 in order to complete the job and handed over to the client, [YYYY]. The fact is that I was not employed further by [Company B] after 23 May 2004 and I was not compensated monetary neither for my dismissal. I would agreed (sic) to be taxed for this (sic) gratuities of \$194,814 if I were further employed by [Company B] after 23 May 2004. The gratuity I received was in fact frankly speaking redundant fee paid to me by [Company B], that is, ‘My employer no longer has a job for me’ ...’.

The Case of the Taxpayer

3. The case of the Taxpayer is that the sum of \$194,814 was a gratuity payable by his employer on the termination of his contract of employment; it was a ‘severance payment’ under the Employment Ordinance and should be exempt from salaries tax. He argues that the ‘extensions’ to his contract of employment were not equivalent to ‘renewals’ of the same.

The Case of the Commissioner

4. The case of the Commissioner is that the said sum of \$194,814 was part of the remuneration and reward paid to the Taxpayer under his contract of employment and should not be exempt from Salaries Tax.

The Law

5. Section 8(1) of the Inland Revenue Ordinance [‘the IRO’] provides as follows :

‘(1) Salaries tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from the following sources –

(a) any office or employment of profit and

(b) any pension.’

6. The relevant part of section 9(1) of the IRO provides as follows :

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'(1) Income from any office or employment includes –

(a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others'

7. Section 2 of the Employment Ordinance contains the following relevant definitions :

(i) *“renewal” (續訂) includes extension, and any reference to renewing a contract shall be construed accordingly’;*

(ii) *“severance payment” (遣散費) means the severance payment payable by an employer to employee under section 31B(1)’.*

8. The relevant part of section 31B(1) of the Employment Ordinance provides as follows :

'31B. General provisions as to right to severance payment

(1) Where an employee who has been employed under a continuous contract for a period of not less than 24 months ending with the relevant date –

(a) is dismissed by his employer by reason of redundancy;

the employer shall, subject to this Part and Part VC, be liable to pay to the employee a severance payment calculated in accordance with section 31G.'

9. Section 31D(2) of the Employment Ordinance provides as follows :

'(2) 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 his employment under the previous contract.'

Our Conclusion

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10. It is settled law that labels such as ‘gratuity’ or ‘severance payment’ in contracts of employment are not conclusive. One must look at the terms of the contract in question and the character of a payment made under it in order to determine the true nature of such payment.

11. On the evidence before us, we are in no doubt that the said sum \$194,814 was part of the remuneration paid to the Taxpayer in accordance with clause 3 of the Contract dated 19 October 2001 and not a ‘severance payment’ within the meaning of section 2 of the Employment Ordinance. The same falls squarely within the meaning of ‘gratuity’ and ‘perquisite’ in section 9(1) of the IRO.

12. The Taxpayer’s claim is certainly not supported by the information supplied by his employer to the Inland Revenue Department. In the calculation sheet relating to the remuneration paid to the Taxpayer supplied by the employer to the Inland Revenue Department as well as in the answers to queries raised by the Inland Revenue Department, the employer did not refer to or describe any part of the said sum of \$194,814 as ‘severance payment’. Indeed, in the letter from the employer to the Inland Revenue Department dated 30 August 2004 it was said :

‘ We confirm that no terminal award or long service payment was paid and included in the amount of \$194,814- reported in the Employer’s Return for the said year. [2003/04]’

13. In all the cases cited by the Commissioner, namely, previous decisions in Cases Nos. D131/00, IRBRD, vol 16, 1, D151/00, IRBRD, vol 16, 101, D51/01, IRBRD, vol 16, 451, D81/01, IRBRD, vol 16, 671, D110/03, IRBRD, vol 19, 44 and D10/04, IRBRD, vol 19, 116, all the payments in question in those cases which were of a nature similar to that in the present case were held by differently constituted Boards to be not severance payments and therefore taxable.

14. In all the circumstances, we have no alternative but to dismiss the Taxpayer’s appeal.

15. We further confirm the Commissioner’s Determination and assessment against the Taxpayer for the year of assessment 2003/04 in that the net chargeable income is \$615,314 with tax payable thereon in the sum of \$103,108.