

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D26/94

Salaries tax – lump sum payment – whether subject to salaries tax.

Panel: Robert Wei Wen Nam QC (chairman), Albert Ho Chun Yan and Frank Pong Fai.

Date of hearing: 2 May 1994.

Date of decision: 12 July 1994

The taxpayer claimed that a lump sum payment she had received from her employer was not subject to salaries tax. She claimed that the nature of the payment was either severance pay or to satisfy what would otherwise be a claim for breach of contract.

Held:

On the facts before it the taxpayer was neither entitled to severance pay nor to any claim for breach of contract. Accordingly the payment was neither a severance payment nor compensation for cancellation of a service agreement. Accordingly it was subject to salaries tax.

Appeal dismissed.

Iris Ng Yuk Chun for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

1. In this appeal madam X (the Taxpayer) appeals against her 1991/92 additional salaries tax assessment in respect of a sum of \$17,893 (the relevant sum) which she claims is not assessable to salaries tax.

2. The relevant sum comprises a sum of \$17,717 and leave pay of \$176. In her statement of grounds of appeal, the Taxpayer claimed that the relevant sum was a compensation for cancellation of service agreement in that having received the relevant sum, she had to 'give up' her years of service from 18 February 1987 to 31 March 1992. At the hearing, she contended that the relevant sum was a severance payment. We were also informed by Miss Ng the representative of the Commissioner that at the objection stage she had contended that the relevant sum was a long service payment.

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3. It is the practice of the Revenue not to tax severance payments and long service payments. Compensation for loss of employment is not taxable because it is not income from employment within the meaning of section 8 of the Inland Revenue Ordinance (the IRO).

4. The following facts were not in dispute. The Taxpayer has been employed by her employer since February 1987. In September 1991 the employer sold some machinery and equipment in order to reorganize its operations. Some employees left the employer of their own accord with effect from 1 November 1991 and lump sum payments termed 'long service payments' were made to those employees for their past services. The other employees, including the Taxpayer, knew about the lump sum payments and requested early termination of service in order to get the 'long service payments'. After negotiations between the employees and the employer, it was agreed that their employment under the existing employment contracts would be terminated and that 'long service payments' calculated up to 31 March 1992 would be paid to the employees who would then each be re-employed by the employer under a new employment contract with effect from 1 April 1992. Pursuant to the agreement, the employer paid the relevant sum to the Taxpayer on 31 March 1992. It included the sum of \$17,717 claimed to be calculated in accordance with the formula provided by the Employment Ordinance (the EO) for the calculation of long service payments. In the 1991/92 employer's return in respect of the Taxpayer, the relevant sum was reported under the item 'Back Pay, Terminal Awards, and Gratuities, etc'.

Severance Payment

5. It seems to us that the Taxpayer would have been entitled to a severance payment if she had been dismissed by reason of redundancy. The question of whether this was a case of redundancy within the meaning of section 31B(2) of the EO was not dealt with by the Deputy Commissioner in his determination, nor was it argued before us. On the facts stated above, we are inclined to the view that this was no a case of redundancy. Further, even assuming for argument's sake that this was a case of redundancy, she would still have needed to be dismissed within the meaning of section 31B(1)(a) of the EO. On the facts, we do not consider that there was a dismissal within the meaning of those provisions, because she was re-engaged under a new contract of employment which took effect immediately on the ending of her employment under the previous contract (see section 31D(2) of the EO).

Long Service Payment

6. Again, for the reason that she cannot be taken to have been dismissed since she was immediately re-engaged under the new contract of employment (see section 31T(2) of the EO), the Taxpayer was not entitled to a long service payment under section 31R(2)(a) of the EO.

Compensation for Cancellation of Service Agreement

7. As there was no loss of employment, there is no question of compensation for such a loss. However, we think that the Taxpayer's argument was that the relevant sum or

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rather the sum of \$17,717 was compensation for 'giving up' her years of service as a result of the cancellation of the previous employment contract. By that we take her to mean that the termination of the previous employment contract together with the immediate commencement of the new employment contract caused her to lose the benefit of her years of service as a qualifying period for claiming a severance payment or long service payment which would have been tax free, whereas the \$17,717 payment, though supposedly equal in amount to a long service payment, was not in law a long service payment because she was not dismissed within the meaning of section 31T(2) of the EO, which provides as follows:

'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.'

Consequently the Revenue practice which exempts long service and severance payments from tax does not apply to the \$17,717 payment. She has therefore lost the benefit of a tax exemption. However, on the facts, the \$17,717 payment was clearly not compensation for the loss of the tax exemption but rather a substitute for a long service payment. There is no question of it being compensation or damages for breach of contract on the part of the employer because the previous employment contract was terminated as a result of the employees' request for early termination of service.

Income from Employment

8. The leave pay of \$176 was income from employment. As for the sum of \$17,717, it was calculated in precisely the same way as a statutory long service payment. In our view, it was a reward for past services, or alternatively an inducement to continue to perform services, or both, and was therefore income from employment. The relevant sum is therefore taxable under section 8 of the IRO. It follows that this appeal is dismissed and that the assessment in question is hereby confirmed.