

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D27/94

Salaries tax – lump sum payment – whether lump sum severance payment or payment for cancellation of service agreement.

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 received a lump sum payment and claimed that the same was compensation for cancellation of a service agreement.

Held:

The lump sum payment was neither severance pay nor compensation for cancellation of a service agreement. Accordingly the lump sum payment 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 Mr X (the Taxpayer) appeals against his 1991/92 salaries tax assessment in respect of a sum of \$56,368 (the relevant sum) which he claims is not assessable to salaries tax.
2. In his statement of grounds of appeal, the Taxpayer claimed that the relevant sum was a compensation for cancellation of service agreement. At the hearing he contended that the relevant sum was a severance payment. We were also informed by Miss Ng the representative of the Commissioner that the Taxpayer had represented by letter to the Inland Revenue Department that a sum of \$55,488 which formed part of the relevant sum was a long service payment. It was not in dispute that the balance of \$880 was leave pay.

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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 his employer since 16 October 1982. At all relevant times he was employed as a worker. 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; lump sum payments termed 'long service payments' were made to those employees for their past services. The other employees knew about the lump sum payments and requested early termination of service in order to get the 'long service payments'. The Taxpayer asserted that he did not ask for early termination of service or long service payment. We shall assume that to be so. However, he was attracted by the offer of the relevant sum which he accepted. By conduct we consider that the Taxpayer must be taken to have supported, albeit tacitly, the course of action pursued by his fellow employees in requesting early termination of service so as to obtain what was called the 'long service payments'. After negotiations between the employees and the employer, it was agreed that 'long service payments' calculated up to 31 March 1992 would be paid to the employees who would then be re-employed by the employer under new employment contracts 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 \$55,488 claimed to be calculated in accordance with a 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 he 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 not a case of redundancy. Further, even assuming for argument's sake that this was a case of redundancy, he 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 provision, because he was re-engaged under a new contract of employment which took effect immediately on the ending of his employment under the previous contract (see section 31D(2) of the EO).

Long Service Payment

6. Again, for the reason that he cannot be taken to have been dismissed since he was immediately re-engaged under the new contract of employment (see section 31T(2) of the EO and paragraph 7 below), the Taxpayer was not entitled to a long service payment under section 31R(2)(a) of the EO.

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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 rather the sum of \$55,488 was compensation for 'giving up' his years of service as a result of the cancellation of the previous employment contract. By that we took him to mean that the termination of the previous employment contract coupled with the immediate commencement of the new employment contract caused him to lose the benefit of his years of service as a qualifying period for claiming a severance payment or long service payment which would have been tax free, whereas the \$55,488 payment, though supposedly equal in amount to a long service payment, was not in law a long service payment because he 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 \$55,488 payment. He has therefore lost the benefit of a tax exemption. However, on the facts the \$55,488 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 \$880 was income from employment. As for the sum of \$55,488, 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.

Section 31T(2) of the EO

9. The sum of \$55,488 was not a long service payment because the Taxpayer was not dismissed within the meaning of section 31T(2) of the EO. Because of this technically, the Taxpayer had to pay over \$20,000 tax on the \$55,488 payment. He stated that he would have refused to take the \$55,488 payment had he been aware of the tax liability. He felt

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aggrieved, although no blame could be laid on the employer or the Revenue. It is hoped that he will feel better when he realizes that it is for every taxpayer to acquaint himself with the relevant law, and that the usual way to achieve this is to obtain legal advice before deciding to enter into a deal.