

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D38/94

Salaries tax – lump sum payment on retirement and re-employment – whether lump sum payment assessable to salaries tax.

Panel: William Turnbull (chairman), Gillian M G Stirling and Yu Yui Chiu.

Dates of hearing: 6 and 10 May 1994.

Date of decision: 22 September 1994

The taxpayer had been employed since April 1975. He reached retirement age in late 1992. His employment was terminated on 28 February 1993 when he was paid a lump sum payment. He was re-employed in a different capacity and on different terms by the same employer. The Commissioner sought to tax the lump sum payment and the taxpayer appealed to the Board of Review.

Held:

On the facts before it there had been a termination of an employment and a new employment albeit with the same employer. In these circumstances the lump sum payment arose out of the first employment contract and the Commissioner was prepared to grant the usual extra statutory concession to the taxpayer. The assessment was remitted back to the Commissioner to consider granting the extra statutory concession.

Appeal allowed.

Cases referred to:

B/R 116/78, IRBRD, vol 1, 283
B/R 15/77, IRBRD, vol 1, 298
D79/88, IRBRD, vol 4, 160
D13/89, IRBRD, vol 4, 242
D19/92, IRBRD, vol 7, 156
Hochstrasser v Mayes 38 TC 673
Shilton v Wilmshurst [1991] STC 88

Chiu Kwok Kit for the Commissioner of Inland Revenue.
Taxpayer in person.

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Decision:

This is an appeal by a taxpayer against a salaries tax assessment which assessed to tax a lump sum payment which the Taxpayer had received from his employer when he reached retirement age. The facts are as follows:

1. The Taxpayer was born in late 1935. Since April 1975 the Taxpayer had been employed by a department store (the employer).
2. Under the terms of employment of the Taxpayer he was required to retire at the age of 57 when he was entitled to be paid a retirement benefit in accordance with the Employment Ordinance.
3. The employer operated a Provident Fund Scheme which had been approved under section 87A of the Inland Revenue Ordinance.
4. The Taxpayer reached the age of 57 in late 1992. On 22 February 1993 the employer gave notice to the Taxpayer that pursuant to the terms of his employment his retirement would become effective on 1 March 1993 and informing him that he would be entitled to a retirement benefit of \$107,750 being two thirds of an amount equal to his basic salary times the period of his length of service. Although the notice to the Taxpayer stated that his retirement 'will be effective 1 March 1993' it would appear that his service actually terminated on 28 February 1993. When the sum of \$107,750 was paid to the Taxpayer, part thereof, namely \$44,430.38 was paid out of the approved Provident Fund Scheme.
5. Sometime prior to 28 February 1993 it was agreed between the Taxpayer and the employer that the employer would re-employ the employee following his retirement upon new and substantially different terms and conditions. Inter alia the rank of the Taxpayer was much lower, he was employed for a period of 12 months, and his salary was greatly reduced. The employment letter stated that the employment of the Taxpayer was to be regarded 'as a new employment'.
6. On 10 August 1993, the assessor raised on the Taxpayer a salaries tax assessment for the year of assessment 1992/93 wherein the assessor assessed to tax the entirety of the long service payment of \$107,750 that the employer had paid to the Taxpayer.
7. The Taxpayer objected to this assessment. By his determination dated 25 February 1994 the Commissioner decided that the assessor was correct in assessing to tax the entire sum of \$107,750 as being 'income from employment' chargeable to tax but allowed a deduction of \$44,430 being that part of the lump sum payment which was paid out of a Provident Fund approved by the Revenue.
8. The Taxpayer duly appealed to this Board of Review against the determination by the Commissioner.

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At the hearing of the appeal the Taxpayer duly appeared before the Board and represented himself. He submitted that under the rules of the Labour Department long service payments as stipulated by the Employment Ordinance are exempt from tax. He said that the Commissioner had held that when he retired from the employment of his employer his employment had not ceased because he had been immediately re-employed. He submitted that this was incorrect because he had been re-employed on totally different terms of employment including a substantial down-grading of his post and a substantial reduction in his wages. He pointed out that he had no option but to retire because under the original terms of employment he was required to retire at the age of 57. He pointed out that he had worked for a very long period of 17 years and 10 months. He said that he would have difficulty in living in his old age but that with the help of his re-employment and the lump sum payment that he had received he would be able to continue to look after himself in a modest way.

The representative for the Commissioner submitted that the Taxpayer had retired from the employment of the employer on 28 February 1993 and had been re-employed by the same employer on 1 March 1993 at a lower salary and with a lower rank. He submitted that the sum paid to the Taxpayer had been computed in accordance with the Employment Ordinance although he pointed out that it appeared that a small error had been made in the calculation by the employer with the result that the Taxpayer had actually been paid slightly less than he was strictly entitled to receive under the Employment Ordinance. However it was accepted that this was an error by the employer and did not affect the principles involved in this appeal. The representative for the Commissioner pointed out that the present appeal related to the balance of \$63,320. This represented the lump sum payment of \$107,750 minus the sum of \$44,430 which had been paid out of the approved Provident Fund.

The representative for the Commissioner pointed out that there had been an error in a booklet issued by the Labour Department which stated that payments made under the Employment Ordinance were tax exempt. He pointed out that this was not correct and said that the Labour Department had subsequently amended the terms of its explanatory booklet.

The representative for the Commissioner submitted that it was clear that the entire payment made to the Taxpayer was in respect of his past services and arose out of his employment. He accepted that there had been a termination of employment and a re-employment on different terms and conditions but pointed out that this made no difference to the nature of the payment. The payment was one which had arisen under the terms of the first contract of employment.

He did however point out that under the terms of the Employment Ordinance, the Taxpayer had not technically been terminated because under section 31T(2) of the Employment Ordinance it is provided that the employment of an employee shall not be taken to be terminated if he is re-engaged by the same employer under a new contract of employment and the new contract commences immediately upon the ending of his previous

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contract. The representative pointed out that this was exactly what had happened in the present case. Accordingly the Employment Ordinance did not have any effect.

The representative for the Commissioner cited the following cases to the Board:

B/R 116/78, IRBRD, vol 1, 283

B/R 15/77, IRBRD, vol 1, 298

D79/88, IRBRD, vol 4, 160

D13/89, IRBRD, vol 4, 242

D19/92, IRBRD, vol 7, 156

Hochstrasser v Mayes 38 TC 673

Shilton v Wilmshurst [1991] STC 88

Having heard the submission of the representative for the Commissioner, the Board found much merit in what the representative had said as a matter of legal principle but was concerned that the result of the rigid application of this principle would lead to great injustice. The Board was aware of an extra statutory concession which the Commissioner extended to salary taxpayers on the termination of their employment where they received a long service benefit in accordance with the terms of the Employment Ordinance. The Board said that although it had not yet reached a decision it was likely that it would find that, as a matter of contractual law, the original employment of the Taxpayer had been terminated and a new employment had commenced. The Board might also find that section 31T(2) of the Employment Ordinance had no application to contractual or taxation law because the sub-section stated that an employee shall not be taken 'for the purposes of this part' to be dismissed etc. This made it clear that the sub-section is only intended to apply to that part of the Employment Ordinance in which it is found.

The Board went on to point out to the representative for the Commissioner that if it were so to find on the facts and law before it, it would be of no avail to the Taxpayer because it was not open to the Board of Review to extend an extra statutory concession and furthermore the case did not strictly come within the extra statutory concession because it was clearly not within the provisions of the Employment Ordinance. The Taxpayer was not entitled to any long service or severance pay under the Employment Ordinance because the Taxpayer had been immediately re-employed. The Board pointed out to the representative for the Commissioner that the matter was highly technical because if the employment had terminated on one day and the new employment had commenced 24 hours later there would have been a technical break within the meaning of the Employment Ordinance and the Taxpayer would then have been entitled to the benefit of the extra statutory concession. The Board said that it could not see the reason why the Commissioner would seek to deny the Taxpayer on the facts of this case a benefit which he would have been entitled to receive but for a technicality. The Board adjourned the case, partly heard, to enable the representative for the Commissioner to seek instructions.

Upon the resumption of the hearing the representative for the Commissioner informed the Board that if the Board were to find against the Taxpayer on the ground that

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the payment arose out of the first employment contract and that accordingly the same were taxable, the Commissioner would be prepared to grant to the Taxpayer the benefit of the extra statutory concession in so far as the amount that he received was within the spirit of the Employment Ordinance even though it was not strictly paid thereunder.

Having given the matter careful consideration, the Board was of the view that the amount in question arose from the first contract of employment and accordingly would be subjected to salaries tax unless an extra statutory concession could be extended thereto. As the representative for the Commissioner had indicated to the Board that the Commissioner would be willing to extend this concession on the facts of this particular case the Board hereby remits the case back to the Commissioner with a direction that the Commissioner should favourably exercising his extra statutory concession in favour of the Taxpayer so that the sum of \$63,320 be not assessed to salaries tax.

In the past this Board has drawn attention to the inequity which cases of this nature cause. Fortunately it has been possible for justice to be done to all concerned on the facts of the case before this Board. However, it does appear to this Board that consideration should be given to regularizing the position and to encourage the provision of long service benefits which are intended to help citizens of Hong Kong to provide for their retirement and old age.