

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D55/86

Board of Review:

Robert W. N. Wei Chairman, Donald Q. Cheung and James W. Sweitzer, *Members.*

21 January 1987.

Salaries Tax—Section 9(1) of the Inland Revenue Ordinance—whether the school fees paid by an employer in respect of an employee's daughter constituting income assessable to salaries tax under Section 9(1) of the Inland Revenue Ordinance.

The Appellant entered his daughter at a school in England upon acceptance by him of liability for payment of fees. This liability was later on undertaken by his employer and the school authorities accepted the charge and confirmed it in writing to both parties. The Appellant contended that assessable income must be capable of payment to or on behalf of the employee and as such employer's assuming direct liability for payment of fees could not be classified as income from Appellant's employment.

Held:

The liability of the Appellant to pay the school fees of his daughter remains his own liability notwithstanding the transfer of such liability to his employer under the novation arrangements. The discharge of liability by the employer represents money's worth in the hands of the Appellant of an amount equal to liability.

Appeal dismissed.

(Note: The Appellant has subsequently appealed to the High Court.)

Cases referred to:

Hartland v. Diggines [1926] AC 289
Heaton v. Bell [1970] AC 728
Nicoll v. Austin [1935] 19TC331
North British Railway Co. v. Scott [1923] AC 37
Richardson v. Worrall [1985] STC 693
Tennant v. Smith [1892] AC 150
Wilkins v. Rogerson [1961] 1 Ch. 133

J. G. A. Grady for the Commissioner of Inland Revenue.
David Flux of Peat Marwick & Mitchell for the Appellant.

Reasons:

1. This is an appeal against a salaries tax assessment for the year of assessment 1982/83 as revised by the Inland Revenue Commissioner.

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2. The facts stated in paragraph 1 of the Determination of the Inland Revenue Commissioner dated 17 February 1986 (the Determination) are agreed in their entirety.

3. The facts may be summarised as follows:—

- (1) In about September 1980 G the Taxpayer entered his daughter at a school in England upon acceptance by him of liability for payment of fees.
- (2) On 1 April 1982 G was appointed an executive director of a company pursuant to a Directors Service Contract (Appendix C to the Determination) which provides, inter alia, "... the company will pay education costs of your children ...".
- (3) On 20 April 1982 the company wrote to the school, stating that in consideration of the school continuing to maintain a place for G's daughter, the company would accept the primary liability to pay all fees and expenses in connection with her attendance and schooling until further notice and asking the school to confirm these arrangements by signing & returning an enclosed copy of the letter. (Appendix A)
- (4) On the same day G wrote to the school regarding the company's offer to accept primary liability to pay his daughter's school fees and stating that his own liability in respect of the school fees would be a secondary one in the sense that in the event of the company making a default, he would pay. (Appendix A1)
- (5) Further correspondence on the matter ensued between the school on the one hand and the company and G on the other until 9 June 1982 when the school wrote to the company accepting the primary liability of the company to pay the school fees and signing and returning to the company the copy of the company's letter dated 20 April 1982 (Appendices B1 and E).

4. The question for the Board is whether the school fees paid by the company in respect of G's daughter constitute income assessable to salaries tax.

5. Section 9(1) of the Inland Revenue Ordinance provides:—

"9(1) Income from any office or employment includes—

- (a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance ..."

Mr. Flux for the Taxpayer argued that the advantage in question only readily fitted into the classification of "perquisite". However, since Section 9(1) is not definitive but inclusive, we do not feel that we are restricted to the heads of income mentioned in paragraph (a), in considering whether the advantage in question is income from the Taxpayer's employment.

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6. Mr. Flux then referred to Sections 11B and 11D, saying that assessable income must be capable of payment to or on behalf of the employee. We do not accept this contention. In our view, Section 11D is not intended as a definition of the word “accrue” or “accruing”, but merely deals with the position of payments falling due as distinct from payments received in relation to the question of inclusion of these payments in the taxpayer’s assessable income. In this connection, we have to point out that Section 11D(b) provides that income accrues to a person when he becomes entitled to claim payment thereof and not that income accrues to a person only when he becomes so entitled. Furthermore, Section 9(1) itself contains items of assessable income not capable of payment to the taxpayer, e.g., paragraph (b) the rental value of rent-free accommodation.

7. In our view, on 9 June 1982, by reason of Appendices B1 and E referred to in paragraph 3(5) above, there was a novation between the three parties concerned whereby the primary liability of the Taxpayer to pay the school fees of his daughter was transferred as a matter of contract to the company, the Taxpayer undertaking a secondary liability to pay the same if the company should make a default. Thus each payment of the school fees by the company represents a benefit to the Taxpayer in the sense that he would have had to pay the same if there had been no such transfer of liability. The question is whether this benefit is taxable as part of the income from the Taxpayer’s employment.

8. The benefit may be looked at from two alternative points of view. It may be regarded as a benefit in kind consisting of the provision of free education for the Taxpayer’s daughter by his employer. Alternatively, what constitutes the benefit may be said to be the discharge by his employer of the Taxpayer’s liability to pay school fees (which liability remains his notwithstanding the transfer by novation mentioned above).

9. On the one hand, there are authorities such as *Tennant v. Smith* [1892] AC 150, *Wilkins v. Rogerson* [1961] 1 Ch. 133, *Heaton v. Bell* [1970] AC 728 and B/R 6/70 for the proposition that receipt of benefits in kind gives rise to liability to tax if and only if the benefits can be turned to pecuniary account by the taxpayer. Since the benefit in kind in question cannot be turned to pecuniary account, we are of the view that it is not money or money’s worth in the hands of the Taxpayer and therefore not taxable.

10. On the alternative view, the discharge of a money debt or liability of a taxpayer by his employer, whether by contract, under statute, or voluntarily, represents money’s worth in the hands of the taxpayer and is taxable. This is so even though the discharge is effected as a result of a transfer of the liability from the taxpayer to his employer, because the sum paid in discharge of the debt or liability is part of the taxpayer’s real salary or income.

11. The first in a line of authority for this view is the case of *North British Railway Co. v. Scott* [1923] AC 37. Under Section 6 of the Income Tax Act 1860, assessment of duties under Schedule E in respect of all offices and employments of profit held under any railway company “shall be deemed to be and shall be an assessment upon the company and paid, collected and levied accordingly”. The taxpayer company had a statutory right to deduct the duty so charged out of the emoluments of its officers, but by contract with the officers had

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waived such right. Lord Dunedin says at p. 41, "... it was contended that this was a company debt and not the official's debt ... The Fallacy of this argument consists in ignoring the fact that though this is a company debt the measure of that debt is not any liability of the company, but is what would be the liability of the official under Schedule E if that liability were not transferred to the company by the Section ..." At p. 44, Lord Atkinson has this to say, "... in truth the sum paid by the company is not a sum outside of the officer's salary or independent of it, but is a part of his salary ... the sums paid by the company to satisfy the debts which those officers respectively owed to the Revenue remain part of the profits and gains those officers derive from the offices they respectively hold and are liable to be assessed to Income Tax ..." In our view, this case is clear authority for the proposition that for tax purposes, the liability remains that of the taxpayer notwithstanding a transfer of the liability to his employer.

12. Next comes the case of *Hartland v. Diggines* [1926] AC 289. In accordance with its custom the company by which the taxpayer was employed paid the Income Tax in respect of his salary, though it entered into no agreement, verbal or written, with him to do so. It was held that notwithstanding the absence of a contract, the tax so paid was an emolument and taxable under Schedule E. Whilst in the *North British Railway Co.*'s case, the assessment was on the company, in *Hartland v. Smith* the servant was assessed directly. In the Court of Appeal in *Hartland v. Smith*, the *North British Railway Co.* case was cited as an authority for the proposition that a debt (such as income tax) paid by a third party (such as the taxpayer's employer) is a profit or emolument of the taxpayer. (per Warrington, L.J. [1925] 1 KB 372 at 383, and per Scrutton L.J., *ibid.* at 384). *Ibid.* at p. 378, Pollock MR's comment on the *North British Railway Co.* case is to the effect that that case does not support the contention that it makes any difference to the position of the employee, whether or not the sum was paid on his behalf by a contract with his employer, or under statute, as in the case of a railway company, or merely voluntarily, as in *Hartland v. Diggines*. In the House of Lords, Viscount Cave, LC says at 291-2, "... the effect of the payment was in practice and in fact to relieve the Appellant year after year from his liability for the payment of the tax. It is true that the Appellant did not receive cash in his hands, but he received money's worth year after year."

13. In *Nicoll v. Austin* (1935) 19 TC 331 the taxpayer had entered into an agreement with his employer under which the employer was obliged to pay all outgoings on the taxpayer's residence. A sum was expended by the employer on rates, lighting and heating costs, telephone costs and on the upkeep of the gardens. It was held that these payments represented 'money's worth' received by the taxpayer. In our view it was implicit in the judgement that the items represented liabilities of the taxpayer. *Nicoll v. Austin* is therefore an illustration of the principle that the discharge of a debt owed by the taxpayer represents money's worth in his hands. What is significant for present purposes is that whilst in *North British Railway Co. v. Scott* and *Hartland v. Diggines* the liabilities in question were tax liabilities, in *Nicoll v. Austin* the same principle was applied to other liabilities.

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14. In *Richardson v. Worrall* [1985] STC 693 the same principle was applied to a liability to pay for petrol discharged by the taxpayer's employer through the use of credit card facilities.

15. On these authorities we are clearly of the view that the same principle applies to the present case. The liability of the Taxpayer to pay the school fees of his daughter remains his own liability notwithstanding the transfer of such liability to his employer under the novation arrangements. The discharge of the liability by the employer represents money's worth in the hands of the Taxpayer of an amount equal to the liability.

16. It follows therefore that this appeal is dismissed and that the salaries tax assessment for the year of assessment 1982/83 as revised by the Inland Revenue Commissioner is hereby confirmed.