

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D57/92

Salaries tax – government servant – training scholarship – assessable income – year in which it accrued.

Panel: William Turnbull (chairman), John C Broadley and Douglas C Oxley.

Dates of hearing: 28 October 1992 and 5 November 1992.

Date of decision: 2 March 1993.

The taxpayer was employed by the Hong Kong Government. Under the terms of a training scholarship the taxpayer remained in the employment of the government but was entitled to study leave and during this period was paid certain sums of money. The taxpayer failed to complete the course of study and resumed his full time duties as an employee of the government. Subsequently a question arose as to when certain sums of money paid by the government to the taxpayer during the period of study leave had accrued to the taxpayer. The Commissioner maintained that the monies were a loan by the employer to the employee and accrued to the employee when the government decided that they waived the requirement for repayment.

Held:

The facts of the case were very complex. The employee and employer had resolved their respective rights and obligations when the employee had resumed his full time services in 1982 and accordingly the monies previously paid to the employee accrued to him at that time.

Appeal allowed.

Lee Yun Hung for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

This is an appeal by a taxpayer against a salaries tax assessment in respect of the year of assessment 1987/88. The assessor assessed certain income as arising in the year of assessment 1987/88 whereas the Taxpayer claims that it accrued to him in the years of assessment 1980/81, 1981/82 and 1982/83. The facts are as follows:

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1. The Taxpayer was employed by the Hong Kong Government (the Government) since 1974. In 1980 he was awarded a Government training scholarship.
2. Under the terms of the training scholarship the Taxpayer remained in the employment in the Government but was entitled and required to attend a four-year full-time degree course at a university in Hong Kong followed by practical training in a government department for a further period of eighteen months. We refer in this decision to the complete five and a half year course as 'the study course'.
3. The Taxpayer embarked upon the study course in late 1980 but through no fault of his own ceased his studies in late 1982 after a period of less than two years and returned to his full-time employment with the Hong Kong Government. The Taxpayer is still in the employment of the Government.
4. During the period that the Taxpayer was pursuing the study course he was paid one half of his salary in the usual way and in addition received certain other payments from the Government and it is these other payments which are the subject matter of the dispute between the parties. These other payments received by the Taxpayer from the Government in addition to his half salary totalled \$85,611 and were as follows:

<u>Period</u>	<u>Amount</u>
	\$
1 January 1981 to 31 March 1981	10,545
1 April 1981 to 31 March 1982	49,470
1 April 1982 to 12 September 1982	<u>25,596</u>
Total:	<u>85,611</u>

5. The arrangements between the Taxpayer and the Government were complicated and form the essence of the dispute between the Taxpayer and the Commissioner. Accordingly we do not set out our findings in these facts but deal with the same later in our decision.
6. On 18 December 1990 the assessor raised an additional salaries tax assessment for the year of assessment 1987/88 on the Taxpayer to bring to charge the foregoing sum of \$85,611 (with tax payable thereon of \$19,958) which the assessor claimed represented loans made to the Taxpayer by the Government during the period from 1 January 1981 up to 12 September 1982 and which the assessor stated were loans which the Government had waived on 15 January 1988.

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7. The Taxpayer objected to this additional salaries tax assessment and pointed out inter alia that the sum of \$25,596 had already been assessed to salaries tax in the year of assessment 1982/83.
8. By his determination dated 14 July 1992 the Deputy Commissioner decided that the additional salaries tax assessment for the year of assessment 1987/88 should be reduced by excluding therefrom the sum of \$25,596 which had been previously assessed to salaries tax and accordingly the tax payable was reduced from \$19,958 to \$15,003.
9. The Taxpayer duly appealed against this determination to the Board of Review.

At the hearing of the appeal the Taxpayer appeared before the Board in person and elected to give evidence. He submitted that the additional monies paid to him by the Government should not have been assessed to salaries tax in the year of assessment 1987/88.

The representative for the Commissioner submitted that the monies had been correctly assessed in the year of assessment 1987/88 but that as part of the monies had already been erroneously assessed in a prior year the Commissioner was agreeable to the additional assessment being reduced by the amount of \$25,596 with the tax payable of \$19,958 being reduced to \$15,003.

As mentioned above the Taxpayer gave evidence and was cross examined. Also we have the benefit of having read a number of documents and letters which were tabled before us. As it is the very nature of the payments totalling \$85,611 made by the Government to the Taxpayer which is in dispute we have not tried to find this as a matter of primary fact though obviously they are primary facts.

We have no hesitation in finding that the Taxpayer was truthful in the evidence which he gave. However care must be taken to distinguish between what he said as fact and what were legal submissions or legal interpretations of those facts. We will now deal at some length with the evidence of the Taxpayer which we accept as correct.

The Taxpayer was in the full-time employment of the Government. Some time before September 1980 he applied to the Government and was granted a four-year full-time study scholarship at a university plus eighteen months practical training in a government department during which period the Taxpayer would be paid only one half of his salary. It was a requirement of the scholarship that upon the successful conclusion of his studies and training the Taxpayer would work for the Government for five years. As mentioned in fact 2 above it is convenient for us to describe this complete five and a half year course as 'the study course'.

The Taxpayer entered into a written undertaking with the Government dated 24 October 1980 in the following form:

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‘In consideration of any fees, travel costs, allowances, or other moneys which may be paid by or on behalf of the Government of Hong Kong to me or on my behalf in connection with the course of study detailed below I agree:

- (a) to use my best endeavours to complete the said course successfully and to sit for any prescribed examination;
  - (b) at the termination of the said course, to return to Hong Kong as required by the Government; and
  - (c) to continue in the service of the Government for a period of not less than five years following the termination of training.
2. Should I fail to complete the said course or should my work or conduct during the said course be, in the opinion of the Secretary for the Civil Service, unsatisfactory or should I fail to sit for any prescribed examinations or should I fail to return to Hong Kong as required or fail to continue in the service of the Government for the said period of not less than five years, I undertake to refund and repay immediately on demand to the Government of Hong Kong all the moneys expended on my behalf in connection with the said course.

3 Details of course of study:

- (a) Description: Bachelor of [a degree course], Postgraduate Certificate Course in [this subject] and eighteen month [training specified].
- (b) Dates : Commencing late 1980 for five and a half years.
- (c) Location : [Courses specified] – a university [training specified], Hong Kong Government’

The undertaking is singularly badly drafted but in our opinion the meaning is quite clear. In a number of different circumstances which included the failure by the Taxpayer to complete the study course of five and a half years, the Government would have the right on demand to require the Taxpayer to refund and repay all monies expended on his behalf by the Government in connection with the five and a half year course.

During the period from 26 September 1980 to 1 January 1981 the Taxpayer only received payment of one half of his salary. Later there was a policy change and with effect from 1 January 1981 he was paid by the Hong Kong Government the other half of his monthly salary and this arrangement continued until he ceased his studies in late 1982. As we have stated in fact 4 above he received a total of \$85,611 under this new arrangement. First of all we must consider the nature of this additional sum of \$85,611. It is perhaps unfortunate that this case has only come before the Board of Review towards the end of

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1992 which is over ten years from when the relevant and important facts occurred. The agreement relating to the second half of the pay of the Taxpayer was evidenced by a memorandum dated 16 February 1981 from the Civil Service Training Division of the Government Secretariat to the Attorney General which read as follows:

‘Approval in principle is given for the Taxpayer to receive full-pay study leave instead of half-pay with effect from 1 January 1981 provided that the additional half-pay is bonded and has to be refunded in full should he resign before completing the undertaking. Please arrange for the bond to be signed by the officer and forwarded to this division for formal approval.’

The Attorney General then proceeded to have the requested bond prepared and under cover of a memorandum dated 14 April 1981 a bond which had been duly executed by the Taxpayer was sent to the Civil Service Training Division. The drafting of the bond again leaves much to be desired. It provided:

‘for the repayment to the said Government loan or loans to the Trainee calculated according to half of the full salary pertaining to the terms of the Trainee’s substantive office which the Trainee will be receiving starting from 1 January 1981 for the remaining period of the training scholarship awarded by the said Government to the Trainee on 7 October 1980.’ (The foregoing faithfully quotes a grammatical error in the original document.)

The formal condition of the bond read as follows:

‘Now the condition of the above-written bond is such that if the Trainee continues in the service of the Government of Hong Kong for the period stipulated in the document entitled “Undertaking By An Officer To The Government In Respect of Training Provided” signed by the Trainee on 24 October 1980, then the above-written bond shall be void but otherwise the same shall remain in full force and effect.’

In the circumstances of the case before us it is difficult to interpret the meaning of this bond. When the Taxpayer accepted the scholarship he executed an undertaking and the agreement was that he would be paid half of his salary during the scholarship period. Subsequently the Government agreed to increase this amount and pay him the whole of his salary as evidenced in the memorandum dated 16 February 1981. Nothing can be clearer than the statement ‘approval in principle is given for the Taxpayer to receive full-pay study leave instead of half-pay’. Presumably this evidenced the agreement which then existed between the Taxpayer and the Government. The Attorney General seems to have ignored the instructions he received and to have prepared a bond on the basis that the Taxpayer would not receive his full pay with an obligation to refund half thereof but would receive a loan of an equal amount. In summary we appear to have the position that the Taxpayer and his employer had agreed with effect from 1 January 1981 that the Taxpayer would receive his entire salary with an obligation to refund part thereof if he should leave the service of the Government before completing his studies of five and a half years and thereafter working

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for the Government for a further five years. A bond was then executed under which the Taxpayer agreed to repay to the Government any loans which he received representing half of his pay.

The next event was when the Taxpayer through no fault of his own ceased his studies. Unfortunately there does not appear to have been any formal document executed between the Taxpayer and the Government when he ceased his studies and returned to full-time employment. However we have the benefit of having seen a number of inter office memoranda which were created at that time and which the Taxpayer and the Commissioner accept as correctly representing the situation as it then existed. We also have the testimony of the Taxpayer.

A memorandum of 23 September 1982 was sent by the Civil Service Training Centre to the Head of the Department of the Hong Kong Government where the Taxpayer was working. It referred to a previous memorandum and included the following statement:

‘Since [the Taxpayer’s] failure in his studies is in no way due to lack of diligence [sic] and misconduct on his part, he will not be required to refund the training costs to Government.’

From associated correspondence, the evidence of the Taxpayer, and the fact that we have no knowledge of any ‘training costs’ other than the second half of the salary of the Taxpayer paid to him by way of loan or refundable amount we find that ‘training costs’ mean the second half of the Taxpayer’s salary comprising the said sum of \$85,611.

It was the evidence of the Taxpayer, which we accept, that he considered the matter to then be closed. He had failed to complete his studies, it had been accepted that the failure was not his fault, and he had resumed his full-time duties. He had no further obligation to refund or repay the sum of \$85,611. In his view he had been penalised because he had lost certain increments and pension entitlements and he did not consider himself under any obligation to continue to serve the Government. However if he did have such an obligation then, in accordance with the Government Regulations which governed his employment, it would be for a reduced period of three years and not the original period of five years because he had only been away on study leave for a period of less than two years and not the originally envisaged period of five and a half years.

The Taxpayer now cannot state with certainty what he included in the tax return of his emoluments subject to salaries tax for the year of assessment 1982/83. He believes that he included in his tax return the full amount of the salary which he received which included the sum of \$25,596. The Taxpayer does not now have a copy of his tax return for that year and likewise the Inland Revenue Department are unable to produce a copy. What the Taxpayer has been able to produce is the employer’s tax return made out by the Government and filed with the Inland Revenue Department a copy of which was given to the Taxpayer at the relevant time. This employer’s tax return stated that the Taxpayer had received as salary in that year the full amount of his salary which included the said sum of \$25,596. The Taxpayer has also been able to produce a salaries tax assessment for that

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year which shows that he was duly assessed to tax on all of his taxable emoluments which included the said sum of \$25,596. Whether or not the previous sums of \$10,545 and \$49,470 in the two previous years had been included in tax returns and been duly assessed to tax is not known and neither the Taxpayer nor the Commissioner were able to produce any conclusive evidence. The Taxpayer was under the impression that he would probably have included such amounts because of what occurred in the third year of assessment namely, the year of assessment 1982/83. The representative for the Commissioner indicated that this could have been the position but was not able to confirm or deny what had happened because the records are not now available.

The next event took place some years later in 1987 when for some unknown reasons which were also unknown to the Taxpayer the Secretary for the Civil Service sent a memorandum dated 18 December 1987 to the Head of the Department where the Taxpayer was working referring to the training scholarship 'from late 1980 to late 1982', stating that the Taxpayer had received a loan of 50% of his substantive salary the repayment of which 'will be waived upon completion of five years of post-training service as stipulated in his undertaking'. The memorandum went on to state that the Taxpayer resumed his duties on 13 September 1982 and asked for verification of the date when he would have completed his five-year mandatory service. Why that memorandum was created we do not know and it presupposes that the Taxpayer had an obligation to serve for five years commencing 12 September 1982. There then followed a series of inter-departmental memoranda including one dated 15 January 1988 copied to the Commissioner of Inland Revenue which included the following sentence:

'The Inland Revenue Department will follow up on any tax implications.'

This memorandum of 15 January 1988 also included a statement that as the five-year period had been completed 'a waiver is hereby granted to the repayment of the said half-pay loan'. We have no idea what the intention of this was supposed to be because it would seem that the memorandum is of no effect in granting a waiver if any was required because it was a memorandum from the Secretary for the Civil Service to the Head of the Department for which the Taxpayer was working and was copied to the Commissioner of the Inland Revenue and the Director of Accounting Services but not to the Taxpayer. An inter-departmental memorandum about which the Taxpayer had no knowledge and which was not brought to his attention cannot be of any effect to change the contractual arrangement between himself and his employer.

The next event was when the assessor on 18 December 1990 raised the additional assessment to salaries tax for the year of assessment 1987/88 which is the subject matter of this appeal. It would appear that the assessment was issued without reference to the Taxpayer and unilaterally by the assessor who had at the end of 1990 decided to act on the copy of the memorandum dated 15 January 1988 which according to the copy we have tabled before us had actually been received by the Inland Revenue Department on 19 or 20 January 1988. We have no information as to why it apparently took nearly three years for an assessment to be issued and why the assessment was apparently issued without reference to the Taxpayer.

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The Taxpayer objected to this additional assessment. In his submissions to the assessor and in his evidence before us the Taxpayer raised the interesting point that in respect of the year of assessment 1982/83 he had already been assessed to tax on the said sum of \$25,596.

Having set out the facts in full we now summarise the salient points. The Taxpayer was granted a period of five and a half years of study leave on half pay which he accepted. A few months later his employer offered to pay him the other half of his salary subject to the same being liable to be refunded by the Taxpayer. He accepted this offer and was paid the other half of his salary. The Taxpayer failed to complete the study course and resumed his full-time duties after slightly less than two years. At that moment in time the Taxpayer was in breach of an undertaking which he had given to the Government under which he had undertaken to complete the entire five and a half year course of study. The Government was entitled under the undertaking to require the Taxpayer to make repayment to the Government of all the monies expended by the Government on behalf of the Taxpayer in connection with the said course of study. As we have said the undertaking referred to continuing in the service of the Government for a period of not less than five years 'following the termination of training' which we have found means the successful completion of the entire course of study. Accordingly the five-year service provision could not and did not apply.

This then leads us to consider the meaning of the bond. In the unusual circumstances which had arisen the meaning of the bond is difficult to understand. It refers to completion of the five-year period specified in the undertaking. However the five-year period specified in the undertaking only starts to operate at the end of the five and a half year study course. Fortunately for this Board it is not necessary for us to delve into whether or not the bond is void for uncertainty or was frustrated by the circumstances of this case because the events which took place in 1982 and 1983 make this immaterial.

It is quite clear to us that when the Taxpayer ceased his studies in late 1982 a situation arose which neither he nor the Government had envisaged. Though he was technically in breach of his undertaking it was through no fault of his own. It was then necessary for the Taxpayer and his employer to reach agreement with regard to his continued employment in the light of the then circumstances. This they did and the matter was resolved to the satisfaction of both parties. The Government refused to allow the Taxpayer to have all of the salary increments and pension entitlements to which he would have been entitled if he had completed the study course but he was not required to refund 'the training costs' to Government. Whilst it can be argued that 'training costs' did not include the additional half pay received by the Taxpayer we are satisfied that it was the agreement between the Government and the Taxpayer that the entire unfortunate matter was then closed and that thereafter the Taxpayer could continue with his service with the Government without further obligations on his part relating to past events. The Taxpayer when giving evidence was quite clear and precise on this point and what was his understanding at that time. This we accept as being true.



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We find considerable support in the decision which we have reached from the fact that the Taxpayer was duly assessed to tax on the sum of \$25,596 in the year of assessment 1982/83 and may well have been assessed to the two earlier amounts in the two prior years. In his determination and in answer to questions from the Board the Commissioner indicated that as a matter of ex-gratia he would deduct the sum of \$25,596 from the assessment against which the Taxpayer has appealed. However as we pointed out to the representative for the Commissioner such ex-gratia offers are not something which this Board can countenance. We are bound by the law and if this had been a loan which was waived in 1987 as stated by the Commissioner then we would have been obliged to uphold the entirety of the assessment against which the Taxpayer has appealed even though it would involve him paying tax twice on the sum of \$25,596 and might well involve double tax on the whole amount of \$85,611.

Finally we comment that it is unfortunate that this matter was taken so long to come before this Board and we also suggest that in cases of this nature the Government might wish to review its modus operandi because to carry forward by way of loan sums paid to a taxpayer and then waive the loan at the end of a period would involve a very substantial financial burden being placed upon a taxpayer at one moment in time.

For the reasons given this appeal is successful and we direct that the assessment against which the Taxpayer has appealed should be annulled in its entirety.