

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D74/02

Salaries tax – sections 8, 9 and 68(4) of the Inland Revenue Ordinance ('IRO') – whether or not the bonus was part of the remuneration payable and paid to the taxpayer under the employment agreement.

Panel: Patrick Fung Pak Tung SC (chairman), Barry J Buttifant and C Roger Moss.

Date of hearing: 5 September 2002.

Date of decision: 25 October 2002.

The taxpayer entered into the employment of Company A as from 11 April 1994. The bonus award under the incentive plan of the employment agreement will be pro-rated based on the length of service from commencement date to 31 December 1994. In January 1999, Company A and the taxpayer entered into a termination agreement.

The issue is whether salaries tax is payable on the bonus in the sum of \$119,160. The taxpayer's case is that the said sum was a redundancy payment payable and paid to him upon the termination of his employment and therefore not taxable. The Commissioner's case is that the said sum was part of his remuneration under his employment contract with Company A and therefore taxable.

Held:

1. The Board was of the view that the sum of \$119,160 was part of the remuneration payable and paid to the taxpayer under the employment agreement. The Board did not agree with the taxpayer's assertion that the said sum was paid to him as a matter of discretion on the part of Company A and that if Company A were not to pay him that sum, there was nothing he could do about it. In his evidence, the taxpayer confirmed that he had been paid similar sums along the same line under the 'local Incentive Plan' in previous years, although there were fluctuations. The Board believed that if Company A were not to pay him the said sum, he would have been able to sue for the same. He would have been able to rely on the practice of payments along the same line in previous years and say that his bonus could and should be calculated on the same basis as in the previous years.

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2. The Board was of the view that the termination agreement was really in the nature of a statement of account worked out between the parties to set out the rights and entitlement of the taxpayer under the employment agreement so as to avoid any possible dispute in future.
3. In all the circumstances, the Board was not satisfied that the taxpayer had discharged the necessary onus on him.

Appeal dismissed.

Fung Ka Leung for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal by the Appellant ('the Taxpayer') against an assessment dated 23 November 1999 for salaries tax for the year of assessment 1998/99 issued by the Respondent ('the Commissioner'). An objection was lodged by the Taxpayer against such assessment. By his letter dated 26 February 2002, the Commissioner made a determination against the Taxpayer whilst reducing the net chargeable income of \$797,516 with tax payable thereon of \$125,077 to a net chargeable income of \$640,782 with tax payable thereon of \$98,432. The Taxpayer has brought this appeal against such determination.

Lateness of the appeal

2. The Commissioner took a preliminary objection against the Taxpayer for filing the notice of appeal out of the one-month period allowed under section 66(1) of the IRO for the lodging of a notice of appeal.

3. The Taxpayer admitted that he was late in filing his notice of appeal but asked the Board to grant him an extension of time under section 66(1A) of the IRO on the ground that he was prevented from lodging the same by his absence from Hong Kong at the material time.

4. We heard argument by the parties on this point and decided that we would deal with the matter together with the merits of the case. We then proceeded to hear evidence and submissions on the merits.

The facts

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5. By an agreement entered into between Company A and the Taxpayer in March 1994 ('the Employment Agreement'), the Taxpayer agreed to enter into the employment of Company A as from 11 April 1994 on the terms set out therein.

6. Two of the terms of the Employment Agreement read as follows:

' Incentive Plan

You will participate in the local Incentive Plan to receive up to a maximum of two months salary which will be based on your performance against objectives to be agreed upon between you and your supervisor. For 1994, your bonus award will be pro-rated based on your length of service from your commencement date to December 31, 1994.

Termination

Termination notice will be in writing and in accordance with Company policy. Current policy requires a one month notice period to be provided in the event of termination of an employee's employment.'

7. In January 1999, Company A and the Taxpayer entered into a termination agreement ('the Termination Agreement') whereby the Taxpayer agreed to terminate his employment with Company A on 6 January 1999 on the terms set out therein.

8. The relevant parts of paragraph 2 of the Termination Agreement read as follows:

' 2. Benefits

Employee and the Company agree that termination benefits shall be limited to the following:

2.01 Employee will receive a 30-day notice period on Jan. 6, 1999. The 30-day notice payment-in-lieu for the notice period Jan. 6, 1999 to Feb. 5, 1999 will be paid on or around Jan. 25, 1999.

2.02 Employee will receive salary payment for five days worked in January 1999 (Jan. 1, 1999 to Jan. 5, 1999 inclusive). This payment will be paid on or around Jan. 25, 1999.

2.03 Employee will receive a Termination Payment of HK\$71,250 representing severance payment as required by Law. This payment will be paid on or around Jan. 25, 1999.

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- 2.04 Employee will receive the benefits which will be made payable to Employee by the Trustee ([Bank B]) in accordance to the rules and regulations of the Retirement Plan of [Company A]. Employee and Employer Plan contributions will cease on Jan. 31, 1999 in accordance to Plan contribution guidelines.
- 2.05 Employee will receive a prorated 13th month bonus for the period Jan. 1, 1999 to Jan. 5, 1999 (five days). This prorated payment will be paid on or around Jan. 25, 1999.
- 2.06 Employee will be compensated for any approved unused vacation carried over from 1998 and prorated vacation days for the period Jan. 1, 1999 to Jan. 5, 1999 inclusive.
- 2.07 Upon Company receiving Employee's Signed Termination Agreement, Employee shall be entitled to local incentive payment (LIP) for 1998. This payment amount is to be determined according to company guidelines and will be paid on or around Mar. 1, 1999.
- 2.08 Upon Company receiving Employee's Signed Termination Agreement, Employee shall be entitled to an additional Termination Payment of HK\$34,988 to be paid on or around the 25th of each month beginning Feb. 25, 1999 and ending May 25, 1999.
- 2.09 Upon Company receiving Employee's Signed Termination Agreement, Employee shall continue to participate in the Company-provided medical/group insurance coverage from Jan. 6, 1999 until May 31, 1999. Such insurance shall automatically be terminated if Employee starts to work for any other company or entity, either on a full time or part time basis.

And for the avoidance of doubt Employee hereby acknowledges and agrees that receipt by Employee of the above-mentioned sums is in full and final settlement of all claims which Employee has or may have against Company arising out of or in connection with Employee's employment by Company and/or this termination thereof.

Employee acknowledges that Employee has received concurrently herewith a written statement explaining the calculation of all amounts paid to Employee under Paragraph 2 above.'

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9. The Taxpayer did not produce a copy of the ‘local Incentive Plan’ referred to in the Employment Agreement or of the ‘company guidelines’ referred to in paragraph 2.07 of the Termination Agreement or of the ‘written statement explaining the calculation of all amounts paid to Employee’ referred to at the end of paragraph 2 of the Termination Agreement.

10. The relevant amounts of the various payments made by Company A to the Taxpayer are conveniently set out in the determination, the relevant parts of which read as follows:

‘(4) (a) [Company A] filed a notification under section 52(5) of the Inland Revenue Ordinance and reported the following particulars in respect of the Taxpayer:

- | | | |
|-------|--|-------------------------------|
| (i) | Reason for cessation | : Termination |
| (ii) | Capacity in which employed | : Planning Manager |
| (iii) | Period of employment | : 01.04.1998 to 06.01.1999 |
| (iv) | Particulars of income – | |
| | Salary | \$364,930 |
| | Leave pay | 41,618 |
| | Bonus | 215,498 (note) |
| | Gain realized under share
option scheme | 40,920 |
| | Allowance | 118,824 |
| | Excess severance payment
(\$34,988 × 4)(Fact (3)(b)(ii)) | 139,952 [“the Additional SP”] |
| | | <u>\$921,742</u> |
| (v) | Quarters provided – A flat in Hong Kong for the period
01.04.1998 to 06.01.1999 | |
| | Rent paid to landlord by employee | \$432,096 |
| | Rent refunded to employee | \$354,273 |

Note: The bonus comprised the following –

13 th month salary for 1998	\$88,927
Prorated 13 th month salary for the period 01.01.1999 to 05.01.1999 (Fact (3)(b) (iii))	7,411
The Sum	<u>119,160</u>
	<u>\$215,498</u>

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- (b) [Company A] also declared that the Taxpayer received the following payments upon termination of employment in accordance with the Employment Ordinance which was not included in the remuneration reported in Fact (4)(a)(iv):

Severance payment (Fact (3)(b)(ii))	
\$22,500 × 2/3 × 4.75 (years of service)	\$71,250 ["the SP"]
Payment in lieu of notice (Fact (3)(b)(i))	88,927
	<u>\$160,177</u>

- (5) In his Tax Return - Individuals for the year of assessment 1998/1999, the Taxpayer declared the following particulars of income:

Salary (\$364,930 + \$41,618)	\$406,548
Bonus	88,928
Stock options	37,902
Allowances	88,425
	<u>\$621,803</u>

The Taxpayer also reported the same particulars of quarters provided by [Company A] as in Fact (4)(a)(v), save the amount of rent refunded to him by [Company A] was declared as \$353,696.

- (6) The Assessor raised on the Taxpayer the following salaries tax assessment for the year of assessment 1998/1999:

Income as in Fact (4)(a)(iv)	\$921,742
Rental value	
\$921,742 × 10% - (\$432,096 - \$353,696)	13,774
	<u>935,516</u>
<u>Less:</u> Self education expenses	30,000
	<u>905,516</u>
<u>Less:</u> Basic allowance	108,000
Net Chargeable Income	<u>\$797,516</u>
Tax Payable thereon	<u>\$125,077'</u>

11. As said in paragraph 1 above, the net chargeable income and tax payable thereon were revised downwards by the Commissioner to \$640,782 and \$98,432 respectively. Such revision by the Commissioner is not in issue.

The issue

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12. The issue is whether salaries tax is payable on the bonus in the sum of \$119,160 (forming part of the sum of \$215,498) referred to in fact 4(a)(iv) and the note thereto in the determination set out in paragraph 10 above.

The case of the respective parties

13. The Taxpayer's case is that the sum of \$119,160 was a redundancy payment payable and paid to him upon the termination of his employment and therefore not taxable.

14. The Commissioner's case is that the sum of \$119,160 was part of his remuneration under his employment contract with Company A and therefore taxable.

The relevant sections in the IRO

15. The relevant parts of section 8 of the IRO provide as follows:

'8. Charge of salaries tax

(1) *Salaries tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from the following sources –*

(a) *any office or employment of profit; and*

(b) *any pension.*

(1A) *For the purposes of this Part, income arising in or derived from Hong Kong from any employment –*

(a) *includes, without in any way limiting the meaning of the expression and subject to paragraph (b), all income derived from services rendered in Hong Kong including leave pay attributable to such services'.*

16. The relevant parts of section 9 of the IRO provide as follows:

'9. Definition of income from employment

(1) *Income from any office or employment includes –*

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- (a) *any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others ...*

Our finding

17. We are of the view that the sum of \$119,160 was part of the remuneration payable and paid to the Taxpayer under the Employment Agreement.

18. We do not agree with the Taxpayer's assertion that the said sum was paid to him as a matter of discretion on the part of Company A and that, if Company A were not to pay him that sum, there was nothing he could do about it. In his evidence, the Taxpayer confirmed that he had been paid similar sums along the same line under the 'local Incentive Plan' in previous years, although there were fluctuations. We believe that if Company A were not to pay him the said sum, he would have been able to sue for the same. He would have been able to rely on the practice of payments along the same line in previous years and say that his bonus could and should be calculated on the same basis as in the previous years.

19. Furthermore, the Taxpayer's assertion is contradicted by what is said by Accountants' Firm C acting for Company A in a letter to the Commissioner dated 11 February 2002:

'[The Taxpayer's] employment with [Company A] ceased on 6 January 1999. Hence he received a pro-rated 13th month salary for the period from 1 January to 5 January 1999 in the amount of HK\$7,410.60. In addition, [the Taxpayer] received discretionary bonus of HK\$119,160 which relates to the divisions and his performance for the year 1998 under the local incentive plan. [The Taxpayer] would be entitled to receiving these bonuses regardless he remained as the employee of [Company A].'

20. We are of the view that the Termination Agreement was really in the nature of a statement of account worked out between the parties to set out the rights and entitlement of the Taxpayer under the Employment Agreement so as to avoid any possible dispute in future.

21. In any event, the evidence which might have assisted the Taxpayer in his assertion was the 'local Incentive Plan' referred to in the Employment Agreement, the 'company guidelines' referred to in paragraph 2.07 of the Termination Agreement and the 'written statement explaining the calculation of all amounts paid to Employee' referred to at the end of paragraph 2 of the Termination Agreement. Unfortunately, the Taxpayer did not see fit to produce any of those three items. The only inference which the Board can draw from such failure to produce is that they are not favourable to his case.

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22. Section 68(4) of the IRO provides that:

‘The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.’

23. In all the circumstances, we are not satisfied that the Taxpayer has discharged the necessary onus on him.

24. Having found against the Taxpayer on the merits, it is not necessary for us to decide on the preliminary objection regarding the lateness of the appeal.

25. Accordingly, we dismiss the appeal of the Taxpayer. We also confirm the Commissioner’s determination that the net chargeable income is \$640,782 with tax payable thereon by the Taxpayer in the sum of \$98,432.