

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D77/89

Salaries tax – gratuity payable to Government servant – date of payment of gratuity – whether accrued due in year of assessment – sections 11B and 11D of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Chan Pang Fee and Donald Cheung Quintin.

Date of hearing: 13 September 1989.

Date of decision: 28 November 1989.

The taxpayer was a Government servant who was entitled to a gratuity under his employment terms. The tour of service of the taxpayer was due to end in one year of assessment but was extended by the employer so that it ended in the next following year of assessment. The taxpayer requested payment of an interim gratuity to be paid in the year of assessment in which the extended tour of duty was due to end. The request and actual payment was made during the preceding year of assessment. The assessor assessed the gratuity to tax in the preceding year of assessment and the taxpayer appealed and submitted that the gratuity should have been taxed in the next following year of assessment.

Held:

Notwithstanding that the Board was sympathetic to the taxpayer it was obliged to dismiss the appeal because the taxpayer had requested payment during the preceding year of assessment and the payment had in fact been made during the preceding year. On a true interpretation of sections 11B and 11D of the Inland Revenue Ordinance the gratuity was taxable in the preceding year.

Appeal dismissed.

K A Lancaster for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

This is an appeal by a taxpayer against an assessment which included a gratuity which the Taxpayer claims should have been assessed in the next following year of assessment. The facts are simple and undisputed. The dispute relates to the legal and tax interpretation of the facts. The facts are as follows:

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1. The Taxpayer was an officer employed by the Hong Kong Government. He was employed on contract terms which provided for the payment of a gratuity at the end of his period of service.

2. The contract terms between the Taxpayer and his employer were governed by the Civil Service Regulations.

3. The full terms of Civil Service Regulation 614 which related to the entitlement and payment of the gratuity were as follows:

‘614(1) Subject to the terms of agreement in individual cases, a gratuity is payable to an officer serving on agreement upon satisfactory completion of the tour of service required by his agreement, for the period of resident service, the period of vacation or annual leave earned and taken and, if appropriate, the period of direct journey to Hong Kong on first appointment. Such gratuity will be payable as a percentage of total basic salary of substantive rank drawn during the agreement period, at the rate specified in the agreement. In the event of the officer’s death during the tour of service, the amount of gratuity earned will be paid to his estate.

(2) The gratuity relating to the period of the journey to Hong Kong first appointment, where applicable, and for the period of resident service completed will be paid not earlier than four clear working days before the officer’s departure on end-of-agreement leave; that relating to the officer’s end-of-agreement leave will be paid on the expiry of such leave. In the case of an agreement officer on annual leave terms, the gratuity relating to the completed period of service is normally paid not earlier than four clear working days before the commencement of the officer’s final annual leave if it is taken at the end of the agreement, and that relating to the final annual leave is paid on the expiry of the leave. If, however, the final annual leave is not taken at the end of the agreement, the gratuity is paid not earlier than four working days before the completion of the agreement. (Also see (4) below)

(3) (a) If an officer’s head of department considers that payment of the gratuity which falls due to be paid to the officer should be withheld, or if there is any change in the date of the officer’s departure on leave on completion of the agreement, the head of department should give notice to the Director of Accounting Services at least one month before the due date for gratuity payment or before the officer’s departure on leave (for the attention of the officer-in-charge of the Pensions Division), with

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copies to the Secretary for the Civil Service and the Commissioner of Inland Revenue.

- (b) If the Director of Accounting Services is not given any instructions to withhold payment or notified of any change of the officer's departure date within the time limit specified in (a) above, the Director of Accounting Services will automatically arrange payment of gratuity to the officer concerned.
 - (c) If during the one month prior to the due date for gratuity payment or prior to the officer's departure on leave, his head of department considers that payment of the gratuity should be withheld or if there is any change in the date of the officer's departure, the head of department should immediately inform the officer-in-charge of the Pensions Division of the Treasury by telephone, and then forward the written confirmation to the Treasury by hand (with copies to the Secretary for the Civil Service and the Commissioner of Inland Revenue).
- (4) Where a gratuity would have been payable to an officer at the end of his agreement period but for the fact that his agreement has been extended through no fault of his own, his head of department (or an officer not below the rank of assistant director duly authorised by him to deal with such matters) may approve an interim payment of gratuity in respect of that period of service which has been satisfactorily completed as originally required under the terms of the officer's agreement, excluding that period of final vacation leave or annual leave. The Director of Accounting Services should be advised of such approval. Payment of gratuity in respect of the extended period of the agreement is not due until the officer has satisfactorily completed that further period. The approval of the Secretary for the Civil Service should be sought for interim payment of gratuity in circumstances not mentioned above.'

4. There is no evidence of there having been any individual terms of agreement in this case and it is common ground that the gratuity in question is governed in all respects by Regulation 614.

5. In the ordinary course of events 'the tour of service required by his agreement' would have ended on 9 February 1987 and the gratuity would have been paid at that time pursuant to Regulation 614(1).

6. The employer was entitled to request the Taxpayer to extend his tour of service and the employer did so request and the tour of service was extended up to 10 May 1987. Regulation 614(4) applies in such circumstances and entitled the Taxpayer's senior officer (in this case his department head) to approve an interim payment of gratuity in respect of the

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period up to and including 9 February 1987 but not the extended period of the agreement, that is, 10 February up to 10 May 1987.

7. By memorandum dated 10 March 1987 signed by the Taxpayer, the Taxpayer requested his department head to exercise his discretion and approve an interim gratuity in the following terms:

‘In accordance with CSR 614(4) I wish to apply to have my interim gratuity (for the period up to 9 February 1987) credited to my bank account as soon as possible after 1 April 1987.’

8. The reason for this request by the Taxpayer was to enable him to invest his gratuity in units of a unit trust and the reason for his specifying ‘after 1 April 1987’ and underlining this part of his request was to ensure that the gratuity was not assessable to tax until the year of assessment 1987/88. The Taxpayer did not wish to avoid payment of tax but wished to defer payment of tax. He was due to return to Hong Kong to continue his employment under a new contract at the end of the period of home leave to which he was entitled so that he would continue to be taxable in Hong Kong.

9. By memorandum dated 17 March 1987 his department head advised the Director of Accounting Services that the Taxpayer’s agreement had been extended from 9 February 1987 to 10 May 1987 and recommended that an interim contract gratuity be paid to the Taxpayer. The employer then arranged for payment to be made direct to the bank account of the Taxpayer by means of a computer transfer which was credited to the bank account of the Taxpayer as of 31 March 1987. The sum of the interim gratuity was \$131,543,156. Though this sum was stated by the bank as having been credited to the account of the Taxpayer on 31 March 1987 the amount was actually credited to the account at some time after the close of business on 31 March 1987 and before the opening of business on the next following day 1 April 1987. It is not possible to ascertain whether or not this credit was made before or after midnight but the credit was made as of 31 March 1987 and was stated in the bank statement as having been received on 31 March 1987.

10. On 1 April 1987 the Taxpayer made enquiries through the ETC card system to ascertain the balance in his account and was pleased to note that the money had been credited and assumed that the credit had been made on 1 April 1987 as per his request. He did not know that the moneys had been credited to his account on the previous day until some time later.

11. The employer gave notice dated 7 May 1987 to the Taxpayer and the Inland Revenue Department that the interim gratuity had been paid during the year ended 31 March 1987. The Taxpayer drew the attention of his department head to the fact that a mistake had been made. By memorandum dated 21 September 1987 his department head informed the Commissioner of Inland Revenue that a mistake had been made and requested the Commissioner of Inland Revenue to assess the interim gratuity in the year of assessment 1987/88 and not the year of assessment 1986/87.

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12. It is the practice of the Inland Revenue Department to assess payments to tax in accordance with notices given by employers and accordingly acting on the notice given by the employer (fact 11 above), the assessor included the interim gratuity in the assessable income of the Taxpayer for the year of assessment 1986/87. Had the payment of the interim gratuity been paid on or after 1 April 1987 as requested by the Taxpayer or had his gratuity been paid under CSR 614(1) (that is, if he had not requested payment of interim gratuity), the employer would have given notice that payment had been made in the year of assessment 1987/88 and this would have been accepted without query by the assessor. In such circumstances the interim gratuity or the gratuity, as the case may have been, would have been assessed to tax in the year of assessment 1987/88.

13. The assessment for 1986/87 including the interim gratuity was upheld by the Deputy Commissioner of Inland Revenue in his determination dated 16 August 1988 and the Taxpayer appealed to the Board of Review.

At the hearing of this appeal, the Taxpayer appeared on behalf of himself and gave evidence. His evidence was accepted and he was not cross-examined.

The Taxpayer submitted that the gratuity should not have been assessed to tax until the following year, namely, 1987/88. He drew attention to the fact that the payment which had been credited to his account as of 31 March 1987 had been made contrary to his express request. He said that his department head had realized that an error had been made and had requested that the payment be taken into account for taxation purposes in the following year 1987/88 but that this request had been rejected by the Commissioner of Inland Revenue. He expressed his sense of grievance at the decision of the Inland Revenue Commissioner not to agree to the request from his department head and pointed out that both his department head and the Inland Revenue Commissioner were both parts of the same Hong Kong Government which was his employer.

The Taxpayer submitted that the moneys had not been made available to him as required by the proviso to section 11D(a) of the Inland Revenue Ordinance. He pointed out that the Commissioner of Inland Revenue had used this as a ground for refusing to agree to his request that the tax be deferred into the following year. He pointed out that he was unaware of the fact that the money had been credited to his account on 31 March 1987 until later and that as the money had been credited after the close of banking hours he could not have used it and therefore it was not available to him.

He pointed out that under Civil Service Regulation 614(4) he was not entitled to an interim payment but could only request an interim payment. It was then a discretionary matter for the head of department to decide whether or not to grant such a payment. He said that his request for payment on or after 1 April 1987 was in the clearest terms and the head of his department and his employer had acted in good faith but expressly contrary to his request by making the payment in the preceding financial year.

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The Taxpayer said that he had been obliged to pay the tax assessed much earlier than it should have been and this had caused him difficulty and loss because he had had to sell some of the unit trust units which he had purchased.

The representative for the Commissioner submitted that it was irrelevant when the payment was actually made because at any time on or after 10 February 1987 the Taxpayer was entitled to make a claim for payment of an interim gratuity under the terms of Regulation 614(4). He pointed out that under section 11D(b) of the Inland Revenue Ordinance income accrues to a person when he becomes entitled to claim payment thereof. He submitted that the discretion given to the head of department under Regulation 614(4) was not an unfettered discretion but one which must be exercised in favour of a government officer unless there is ground not to do so. He submitted that in the present case the Taxpayer would have been entitled to demand payment of the interim gratuity if the head of department had refused to exercise his discretion.

The Board finds itself in this appeal in a difficult situation. The entire sympathy of the Board lies with the Taxpayer who made an intentional decision in an attempt to regulate his tax affairs in such a way that the tax on his gratuity would not have been payable until the year in which his extended service ended. Had he applied for payment of his interim gratuity by memorandum dated subsequent to 31 March 1987 or had his employer paid the gratuity after 31 March 1987 as requested this case would never have arisen. In either such case the employer would have informed the Inland Revenue Department that the gratuity had been paid during the year of assessment 1987/88 and this would have been accepted by the assessor without query. (See statement by Commissioner's representative referred to below).

However though our sympathy lies with the Taxpayer, our decision must be governed by the facts and a strict application of the law. In this case the Inland Revenue Ordinance gives no discretion. Though we are sympathetic with the Taxpayer we cannot accept his submission that the cause of his problem is the decision of the Inland Revenue Commissioner not to accede to the request of his department head. Not unnaturally the Taxpayer considered both the Inland Revenue Commissioner and his department head to be but different arms of the same agency namely his employer. That however is not the case. Like this Board, the Inland Revenue Commissioner must ascertain the facts and apply the law and has no discretion. The fault, if fault there is, lies not with the Inland Revenue Commissioner but with his department head or the Director of Accounting Services or whoever it was who authorised and effected payment of the interim gratuity with the effective date being 31 March 1987.

The representative for the Commissioner said that if the payment had been made in the subsequent tax year, the employer would have filed the employer's return for emoluments paid to the Taxpayer in the subsequent year and this would have been accepted by the Commissioner and the tax would have been deferred. The question for us to decide is whether this practice of the Commissioner is correct and if so, when the moneys were paid. To answer the first part of this question we turn to the wording of the relevant sections of the Inland Revenue Ordinance, namely sections 11B and 11D.

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Section 11B is the general section which reads as follows:

‘The assessable income of a person in any year of assessment shall be the aggregate amount of income accruing to him from all sources in that year of assessment.’

Section 11B only takes us a very small way down the road. It does not answer the question of what accrues to a person in a particular year. To answer this important question we must look at section 11D which reads as follows:

‘For the purpose of section 11B –

- (a) income which has accrued to a person during the basis period for a year of assessment but which has not been received by him in such basis period shall not be included in his assessable income for that year of assessment until such time as he shall have received such income, when notwithstanding anything contained in this Ordinance, an additional assessment shall be raised in respect of such income:

Provided that for the purposes of this paragraph income which has either been made available to the person to whom it has accrued or has been dealt with on his behalf or according to his directions shall be deemed to have been received by such person;

- (b) income accrues to a person when he becomes entitled to claim payment thereof:

Provided that –

- (i) any lump sum payment received on or after 1 April 1966, being a lump sum payment or gratuity paid or granted upon the retirement from or termination of any office or employment or any contract of employment of an employee or a lump sum payment of deferred pay or arrears of pay arising from an award of salary or wages, whether such a payment is paid by an employer to a person during employment or after that person has left his employ, shall upon the application in writing of the person entitled to claim payment thereof within two years after the end of the year of assessment in which the payment is made be related back and shall then be deemed to be income which has accrued during the periods in which the services or employment, in respect of which the payment was made, were performed or exercised, or, if the relevant periods of service or employment exceed three years, the payment shall be

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deemed to be income accruing at a constant rate over the three years ending on the date on which the person became entitled to claim payment thereof or ending on the last day of employment, whichever is the earlier; and, notwithstanding section 70, an application made by any person under this proviso for the adjustment of an assessment shall, to that extent, be regarded as a valid objection to the assessment under section 64; and

- (ii) subject to proviso (i), any payment made by an employer to a person after that person has ceased or been deemed to cease to derive income which, if it had been made on the last day of the period during which he derived income, would have been included in that person's assessable income for the year of assessment in which he ceased or is deemed to cease to derive income from that employment, shall be deemed to have accrued to that person on the last day of that employment.'

Section 11D(b) states that income accrues to a person when he becomes entitled to claim payment thereof and we must decide when the Taxpayer was entitled to claim payment of this gratuity. The representative for the Commissioner submitted that the word 'claim' should be given a wide interpretation and that the Taxpayer was entitled to claim at any time on or after 10 February 1987 pursuant to the provision of Regulation 614(4). With considerable hesitation, and some reluctance, we agree that the Taxpayer did become entitled to claim payment on 10 February 1987. We say 'with considerable hesitation' because it is difficult for us, without having had the benefit of legal argument, to rule on the meaning of Regulation 614(1) and 614(4). In our view the word 'claim' should not be given an unduly wide meaning but neither should it be made unduly restrictive. The Commissioner's representative referred us to the shorter Oxford English Dictionary definition as:

'To demand as ones due: to seek or ask for on the ground of right.'

In our opinion the Taxpayer was entitled to claim payment of an interim gratuity at any time on or after 10 February. We have given much thought to whether or not the fact that the head of department 'may approve' means that the Taxpayer had no right to claim payment. It is a moot point. If one looks at the strict wording of Regulation 614(4) it does not refer to the Taxpayer making a request or application for payment of an interim gratuity though obviously that is what would normally happen before a head of department would approve an interim payment. However there does not appear to be any restriction on the granting of approval by the head of department. After much consideration we have come to the decision that the Taxpayer could claim payment within the meaning of section 11D(b) of the Inland Revenue Ordinance at any time on or after 10 February. Accordingly the gratuity falls to be assessed after it is paid in respect of the year of assessment 1986/87.

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As mentioned above the Board did not have the benefit of legal argument on the question as to the meaning of the wording of the government contract relating to gratuities. Having found that the gratuity accrued to the Taxpayer during the preceding year in question it is not necessary for us to consider the matter further. However we put on record that even if our finding with regard to this legal question were incorrect we would still dismiss this appeal because technically the Taxpayer received these monies on 31 March 1987. That was the date as of which the monies were credited to his account with his bank. Had he known that the payment had been received by his bankers he could have given instructions to his bankers with regard to the disposal of the funds and his bankers would no doubt have made the appropriate transaction or transactions. For example if he had drawn a cheque against part or all of the gratuity and that cheque had been presented on 31 March it would have been cleared against the proceeds of the gratuity which were credited that day. Likewise he could have given instructions to his bank to place the monies on deposit in which case they would have started earning interest with effect from 31 March 1987. We appreciate that the Taxpayer did not know that the monies had been credited to his account as of 31 March 1987. However that does not affect the strict legal position that the monies had actually been received by him on that day. The wording of section 11D of the Inland Revenue Ordinance says that income accrues to a person when he becomes entitled to claim payment thereof. Even if the Taxpayer was not entitled to claim payment on 10 February, he most definitely was entitled to claim payment and indeed dispose of the money as of 31 March 1987. Accordingly on this basis his appeal would also have to be dismissed.

For the reason given we dismiss this appeal and confirm the assessment appealed against.