

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D78/88

Salaries tax - 'accrued' income - monthly earnings not payable until the following year of assessment - whether assessable in the prior year - ss 11B and 11D of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Lester Kwok Chi Hang and Patricia Loseby.

Date of hearing: 20 January 1989.

Date of decision: 15 March 1989.

The taxpayer was paid on a monthly basis. Under his contract of employment, he was not entitled to receive payment of salary for any month until the 5th day of the following month. This meant that he received his salary with respect to March 1987 on 7 April (which was in the following year of assessment). The IRD assessed these earnings to salaries tax with respect to the prior year.

The taxpayer appealed. He claimed that these earnings should not be assessable until the following year of assessment.

Held:

The March earnings were not assessable until the following year of assessment.

- (a) For salaries tax purposes, under section 11B a taxpayer is subject to tax on income which 'accrues' to him during the relevant year of assessment. However, section 11D makes it clear that, for this purpose, income 'accrues' to a taxpayer only when he becomes entitled to claim payment thereof.
- (b) Under the taxpayer's contract of employment, he was not entitled to claim payment of his March earnings until 5 April.
- (c) Section 23 of the Employment Ordinance, which provides that wages shall become due 'on the expiry of' a wage period, does not affect this conclusion.

Appeal allowed.

D J Gaskin for the Commissioner of Inland Revenue.
Stanley So of Stanley So & Co for the taxpayer.

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Decision:

This is an appeal by the Taxpayer against the amount of salaries tax assessed upon him. He has argued that the salary which he earned during the final month of the year of assessment 1986/87 was not payable to him until a later date in the following tax year and accordingly should not have been included in his taxable emoluments for salaries tax purposes in the year of assessment 1986/87.

The facts are as follows:

1. During the year of assessment ended 31 March 1987, the Taxpayer was employed by a company in Hong Kong ('the employer') as an assistant accountant.
2. The Taxpayer submitted his salaries tax return for the year of assessment 1986/87 showing the following:

	\$
Salary	81,048
Bonus	<u>20,502</u>
	\$101,550
	=====

3. The employer submitted a return in respect of the Taxpayer showing that his salary during the period 1 April 1986 to 31 March 1987 was \$88,640 and not \$81,048 as declared by the Taxpayer.
4. The difference between these two returns was the sum of \$7,592 being the salary which the Taxpayer earned in respect of the month of March 1987 but which was not paid to him until 7 April 1987.
5. The assessor assessed the Taxpayer on his taxable emoluments as returned by the Employer and not as returned by the Taxpayer, that is, the assessor added in the March 1987 salary of \$7,592.
6. The Taxpayer gave formal notice of objection to the assessment and submitted that the salary which he earned in March was not due for payment until 7 April 1987 and was therefore not taxable.
7. In reply to an enquiry from the assessor, the employer stated that 'to allow easy and accurate calculation of our monthly profit and loss account and balance sheet, we have changed the salaries and allowances payment on a monthly basis when fifth is the calendar payment date.'

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8. Evidence was called at the hearing before the Board and, for the reasons stated below, we accept as a fact that the Taxpayer was not legally entitled to claim payment of his March salary until 5 April 1987.

At the hearing of the appeal, the Taxpayer was represented by his tax representative and the manager of the employer was called to give evidence. The representative submitted that, on the facts and evidence before the Board, the Taxpayer was not entitled to claim payment of his salary for March 1987 until 5 April 1987. (In fact it was not paid until 7 April 1987 because of holidays). He submitted that, by virtue of section 11D of the Inland Revenue Ordinance, income only accrues to a person when he becomes entitled to claim payment thereof.

The representative for the Commissioner submitted that, on the evidence before the Board, it had not been proved that the Taxpayer was not entitled to claim payment of his salary until after the end of the year of assessment. He drew our attention to the amendments to the Inland Revenue Ordinance which had been introduced in 1973 which followed the report of the Inland Revenue Ordinance committee published in 1954. He submitted that, upon the Taxpayer rendering his services on 31 March 1987, he had completed his part of his contractual 'bargain' and was entitled to payment for such services. He submitted that the date of actual payment does not determine the time when income accrues and referred us to BRL3/74, IRBRD, vol 1, 159. He submitted that, on the authority of that case, it is clear that income accrues to a person when he has a legal right to receive payment of that income. He pointed out that there was no written contract and submitted that the rights of the Taxpayer had 'crystallized' when he completed his services on 31 March 1987.

The Commissioner's representative drew our attention to the Employment Ordinance which provides that wages shall become due on the expiry of the last day of the wage period and shall be paid as soon as is practicable but in any case not later than seven days thereafter (section 23 of the Employment Ordinance). He pointed out that the Employment Ordinance applied to the Taxpayer's contract of employment and that section 23 makes reference to 'on the expiry of' and not 'after the expiry of'. He submitted that the Taxpayer had a right to claim payment of his wages at midnight on the last day of the month though, as a matter of practical expediency, he would not claim payment or be paid until subsequent thereto. The Commissioner's representative submitted that, if any other interpretation were given, then the wages due at the end of the preceding year should likewise be included in the Taxpayer's emoluments for the current year.

It is clearly necessary that we should first resolve the facts before we can apply the law. The manager of the employer gave evidence and was cross-examined. We accept the evidence given by him. He explained the history of the employer and his group of companies with regard to payment of wages to employees. In the past, the wages of employees had been calculated up to the twentieth day of each month with

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payment being made on the twenty-fifth day. This system was found to be inconvenient for the employer and the terms of employment were changed in December 1986. The effect of this was that the Taxpayer was paid for the period 31 March to 20 April 1986 (both days inclusive) on 25 April 1986 and this salary was included in the employee's tax return for the year 1986/87. Thereafter during the year the same periods were used each month until 20 November 1986. The Taxpayer was then paid for the broken period from 21 November to 30 November with payment being made on 5 December. Thereafter, the Taxpayer's wages were calculated and paid up to the last day of each calendar month with payment being made on the fifth day of the following month. In the month of April 1987, payment was made on 7 April because of holidays.

In his evidence in chief and under cross-examination, the witness was quite clear and categorical that the Taxpayer had no legal entitlement to claim his monthly wages until the fifth day of the following month and that, if any claim were made by an employee including the Taxpayer, the employer would refuse to make payment.

Having accepted the evidence of the witness, we have found as a fact that the Taxpayer was not contractually entitled to claim payment of his preceding month's salary until the fifth day of the next following calendar month.

Having so found this vital fact, we now turn to the wording of the Inland Revenue Ordinance. Section 11B states that 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. If there were no further definition or provision in the Ordinance, we would have no hesitation in finding that the wages of the Taxpayer accrued to him during the month of March and accordingly should be included in his taxable emoluments for the year of assessment 1986/87. However the matter does not end there. Section 11D starts off with the words 'for the purposes of section 11B' and then proceeds to give a statutory definition to the meaning of the word 'accrues'. Sub-section (b) provides that 'income accrues to a person when he becomes entitled to claim payment thereof'. That is a quite clear and unequivocal statement. It leaves no room for doubt. For salaries tax purposes, income does not accrue to a person in the ordinary accounting sense. It only accrues on the date when the Taxpayer becomes entitled to claim payment. As we have found as a fact that the Taxpayer was not entitled to claim payment until the fifth day of the month following the month when he earned his wages, we have no alternative but to find in favour of the Taxpayer and allow this appeal.

The Commissioner's representative argued that the employment of the Taxpayer was governed by the Employment Ordinance and that the Employment Ordinance overrides the clear contractual situation which we have found as a fact. With due respect, we do not agree with that construction of the Employment Ordinance. The Employment Ordinance provides that wages become due on the expiry of the last day of the wage

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period and that they must be paid within seven days. It appears to us that that is what the employer in this case has agreed with the employees. The wages became due on the expiry of the last day of the month but are not payable and therefore cannot be legally claimed until the fifth day of the following month. However, even if we are wrong in this interpretation and application of the Employment Ordinance, it seems to us that 'on the expiry of' means literally what it says. Wages do not become due immediately before the expiry but when the period has expired. In other words, the earliest moment in time when the wages could become due would be the split second after the clock has chimed midnight on the last day of the month. It cannot happen before the expiry and it seems to us that nothing can balance on the notional or theoretical knife edge of midnight. An event or happening must be either immediately before or immediately after. In his submission, the Commissioner's representative sought to draw a distinction between 'on the expiry of' and 'after the expiry of'. Again with due respect we do not think it possible to have three moments in time namely before, during, and after. An event must either be before or after and the words 'on the expiry of' mean from the moment in time when something has expired until any subsequent moment in time thereafter.

We also appreciate the concern expressed by the Commissioner's representative that our decision in this case may have a wide ranging effect on the calculation of taxable emoluments. However, as he pointed out, the preceding month must be included in the subsequent year's tax assessment as well as the exclusion of the last month. In other words, a tax year remains at a 12 month period in all normal cases. In the present case, there was a change of the terms of employment during the year in question and it is that change which has led to this appeal. The Taxpayer was not entitled to claim his wages for March 1987 until the following tax year, that is, in April 1988, and accordingly the amount of his March wages should not have been included in his tax assessment for the year of assessment 1986/87.

For the reasons given we allow this appeal and direct that the assessment appealed against shall be reduced by deducting from the Taxpayer's taxable emoluments as assessed the sum of \$7,592 being his March 1987 salary incorrectly included in his taxable emoluments for the year of assessment 1986/87.