FACV No.22 of 2009

IN THE COURT OF FINAL APPEAL OF THE HONG KONG SPECIAL ADMINISTRATION REGION

FINAL APPEAL NO. 22 OF 2009 (CIVIL)
(ON APPEAL FROM CACV NO. 196 OF 2008)

BETWEEN

FUCHS, WALTER ALFRED HEINZ Appellant

and

COMMISSIONER OF INLAND REVENUE Respondent

Court : Mr Justice Bokhary PJ, Mr Justice Chan PJ, Mr Justice Ribeiro PJ, Mr Justice Mortimer NPJ and Lord Walker of Gestingthorpe NJP
Dates of Hearing : 17 – 18 January 2011
Date of Judgment : 1 February 2011

J U D G M E N T

Introduction

Mr Justice Bokhary PJ :

1. I agree with Mr Justice Ribeiro PJ's judgment.

Mr Justice Chan PJ :

2. I agree with the judgment of Mr Justice Ribeiro PJ.

Mr Justice Ribeiro PJ :

3. The main question raised in this appeal is whether two sums paid to the appellant taxpayer on the termination of his employment are assessable to salaries tax as income from an office or employment within the meaning of section 8(1) of the Inland Revenue Ordinance.[1] As his fall-back position, the taxpayer contends that if his primary argument that the sum is not taxable fails, the disputed income should be apportioned for the purposes of assessment by virtue of section 8(1A).

A. Section 8

4. So far as material, section 8 provides as follows:

> (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—
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> (a) any office or employment of profit ...
>
> (1A) For the purposes of this Part, income arising in or derived from Hong Kong from any employment-
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> (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;
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> (b) excludes income derived from services rendered by a person who-
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> (i) ...
>
> (ii) renders outside Hong Kong all the services in connection with his employment; ...

5. Section 9, defines "income from any office or employment" to include:

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

B. The facts

[1] Cap 112.

6. Commencing in 1976, the taxpayer, Mr Fuchs, was employed by Bayerische Hypo und Vereinsbank Aktiengesellschaft ("HVB"), a German bank registered under Part XI of the Companies Ordinance[2] as a non-Hong Kong company having a place of business in Hong Kong. After working for HVB in Germany until 2000 and thereafter at its Singapore branch, the taxpayer was seconded to Hong Kong in July 2003. On 18 November 2003, he signed a contract of employment ("the employment contract") with HVB to work at its Hong Kong branch, being appointed Managing Director and CEO Asia.

B.1 The employment contract

7. The following terms of the employment contract are relevant:

Clause 1

This agreement will become effective from January 1, 2004.

Clause 3: Duration of agreement

This agreement shall be valid for 3 years (from the commencement date). No less than 6 months prior to expiration, negotiations will be undertaken as to the prolongation of this contract.

Clause 4: Salary & bonus

Your basic salary will be HKD$3,120,000 p.a. paid in 12 equal monthly instalments in arrears.

The Bank will pay a variable bonus for employees, the payment and level of which is discretionary. The payment of any bonus is contingent upon the operating results of the Bank and upon your individual performance. ...

Clause 9: Termination

(a) This agreement may be terminated by either party, without cause, on the date of expiry of the initial term.

(b) Your employment may be terminated immediately by the Bank without prior notice if you shall at any time

- commit any serious or persistent breach of any of the terms of your employment; or

- be guilty of any grave misconduct or wilful neglect in the discharge of your duties; or

[2] Cap 32.

- become mentally disordered and of unsound mind and incapable of managing your affairs, and are certified to be such by a qualified specialist medical practitioner.

(c) In the event that the Bank terminates or purports to terminate this agreement on any grounds other than as set out in clause 9 a) and 9 b), despite your prior written consent to extend this agreement on the basis of customary market conditions for another 3 years and although you have not reached the age of 60 the Bank shall pay to you as agreed compensation or liquidated damages :

- 2 annual salaries

- an average amount of the bonuses paid in the 3 previous years of your employment with the Bank

The Bank shall, not later than the effective date of termination, pay to you the compensation determined in accordance with the above.

Any possible mandatory severance payments are included in the above mentioned compensation sum.

Final clause

This agreement and the rights and obligations of the parties hereto are, in all respects, governed and construed in accordance with the laws of The Hong Kong Special Administrative Region.

B.2 Termination of the taxpayer's employment

8. The taxpayer duly took up his appointment in Hong Kong. However, in June 2005, a takeover of HVB by an Italian banking group known as the UniCredit Group was announced with effect from 17 November 2005. As part of the resultant re-organization, it was decided that the taxpayer's employment would be terminated.

9. The negotiated terms for cessation of his employment are set out in an agreement dated 17 October 2005[3] between the HVB and the taxpayer ("the termination agreement"). It is expressed to be governed by Hong Kong law.[4] It relevantly provides[5] that Mr Fuchs's employment was to end "by December 31, 2005", that is, at the end of the second year of the contract's agreed three-year duration, and that the bank was to pay him "a one-time compensation for the loss of his position due to the termination of the employment

[3] Signed by the taxpayer on 25 October 2005.
[4] Section II, clause 12.
[5] Section 1 and Section II, clause 1.

relationship for operational reasons" in the sum of HK$18,276,667 ("the termination payment").

10. The termination agreement provided a breakdown of the termination payment into three elements, referred to in the courts below as Sum A, Sum B and Sum C, namely:

Sum A: $3,120,000 being a sum equivalent to the taxpayer's salary for the remaining term of the employment contract (12 months);

Sum B: $6,240,000 being "two annual salaries for duration of service with the Bank"; and

Sum C: $8,916,667 being "the average amount of the bonuses paid in the 3 previous years".

C. The decisions leading to this appeal

11. In his tax return for the year of assessment 2005/06, the taxpayer claimed a full exemption for the termination payment on the ground that it represents "damages for releasing contract". The assessor conceded that Sum A was a non-taxable compensation payment but maintained the assessment in respect of Sums B and C. By a determination dated 22 October 2007, the Deputy Commissioner confirmed that assessment.

12. The appeal from that determination was transferred by consent to the Court of First Instance (by-passing the Board of Review) pursuant to section 67 of the Ordinance and, on 26 June 2008, Burrell J allowed the taxpayer's appeal in part, holding that while Sum C was rightly assessed to tax, the assessment of Sum B should be annulled as falling outside the charge.[6] The taxpayer's fall-back argument that Sum C was a payment attributable to the taxpayer's entire career with the bank over some 29 years and that only about 6.8% of it should be taxed as representing Hong Kong income, was rejected. Burrell J held that Sum C was not referable to pre-Hong Kong employment but was paid pursuant to the employment contract.[7] He also held that "attempts to redefine [Sum C] by reference to German law" were misplaced, pointing out that there was in any event no admissible evidence of German law.[8]

13. The taxpayer appealed and the Revenue cross-appealed to the Court of Appeal. By its judgment handed down on 30 October 2009,[9] the Court of Appeal unanimously dismissed the taxpayer's appeal and allowed the Revenue's cross-appeal. After a wide-ranging examination of the authorities, Tang VP held that both Sums B and C were caught by the charging provisions of section 8 and, in agreement with the Judge, rejected the

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6 HCIA 1/2008 (26 June 2008).
7 At §45.
8 At §46.
9 CACV 196/2008, Tang VP, Cheung JA and Chung J.

apportionment argument. Cheung JA reached the same conclusions after his analysis of the case-law and Chung J agreed with both judgments.

D. The applicable principles

D.1 The test

14. Whether a payment received by an employee on termination of his employment is taxable turns on the construction of section 8(1): Is such payment "income ... from ... any office or employment of profit"? As we have seen, section 9 defines "income" widely to include "any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance". There is no dispute that Sums B and C come within that definition. The key issue is therefore whether those amounts constitute income "from" the taxpayer's "employment".

15. The same issue has commonly arisen in relation to similar statutory wording in United Kingdom legislation. Thus, for instance, in *Hochstrasser v Mayes*,[10] the House of Lords had to consider section 156 (2) of the Income Tax Act, 1952 which imposed a charge to tax on "the profits or gains arising or accruing from" any "office, employment or pension". And in *Shilton v Wilmshurst*,[11] their Lordships had to construe Schedule E under the Income and Corporation Taxes Act 1970, s 181(1) which provided: "Tax under this Schedule shall be charged in respect of any office or employment on emoluments therefrom..." Schedule E under section 19(1) of the Income and Corporation Taxes Act 1988, examined by the House of Lords in *Mairs v Haughey*,[12] was in the same terms, with "emoluments" defined (in section 131(1)) as including "all salaries, fees, wages, perquisites and profits whatsoever". Those charging provisions differ little in substance from our own charge levied on "income from an office or employment of profit".[13] The Hong Kong courts have accordingly found helpful guidance in the English jurisprudence when construing section 8(1) of our Ordinance.

16. The test which has evolved in that jurisprudence for determining whether income is "from the taxpayer's employment" and therefore assessable rests largely on the three House of Lords decisions just mentioned. It is clear that not every payment which an employee receives from his employer is necessarily income "from his employment".[14] It is not sufficient to qualify a payment as such income simply to say that the employee would not have received the sum in question if he had not been an employee.[15] The test, formulated in positive terms as to when the sum is assessable, has been expressed as follows:

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10 [1960] AC 376 .

11 [1991] 1 AC 684.

12 [1994] 1 AC 303.

13 While in the UK legislation, income which falls outside Schedule E may be taxable in a different amount under Schedule D, this does not affect the analytical guidance provided by the case-law.

14 *Hochstrasser v Mayes* [1960] AC 376 at 388.

15 *Ibid* at 391-392, 394.

(a) In *Hochstrasser v Mayes*[16] Lord Radcliffe stated:

"The test to be applied is ... contained in the statutory requirement that the payment, if it is to be the subject of assessment, must arise 'from' the office or employment. ... I think that their meaning[17] is adequately conveyed by saying that, while it is not sufficient to render a payment assessable that an employee would not have received it unless he had been an employee, it is assessable if it has been paid to him in return for acting as or being an employee."

(b) In the same case, Viscount Simonds approved Upjohn J's statement in the lower court as follows:

"... the authorities show that to be a profit arising from the employment the payment must be made in reference to the services the employee renders by virtue of his office, and it must be something in the nature of a reward for services past, present or future."[18]

(c) In *Shilton v Wilmshurst*,[19] Lord Templeman expanded on the test:

"Section 181 is not limited to emoluments provided in the course of employment; the section must therefore apply first to an emolument which is paid as a reward for past services and as an inducement to continue to perform services and, secondly, to an emolument which is paid as an inducement to enter into a contract of employment and to perform services in the future. The result is that an emolument 'from employment' means an emolument 'from being or becoming an employee.' The authorities are consistent with this analysis and are concerned to distinguish in each case between an emolument which is derived 'from being or becoming an employee' on the one hand, and an emolument which is attributable to something else on the other hand, for example, to a desire on the part of the provider of the emolument to relieve distress or to provide assistance to a home buyer. If an emolument is not paid as a reward for past services or as an inducement to enter into employment and provide future services but is paid for some other reason, then the emolument is not received 'from the employment'."

(d) In *Mairs v Haughey*,[20] while stressing that each case ultimately involves applying the statutory language to the facts, Lord Woolf stated that

16 [1960] AC 376 at 391-392.

17 That is, the statutory words' meaning.

18 *Ibid* at 388. Viscount Simonds thought the reference to "past services" might be open to question but otherwise considered the statement entirely accurate.

19 [1991] 1 AC 684 at 689.

20 [1994] 1 AC 303 at 321.

general assistance is provided by the speeches in the two decisions cited above as to the applicable test.

(e) In the English Court of Appeal in *EMI Group Electronics v Coldicott*,[21] after an extensive review of the authorities, Chadwick LJ noted Lord Woolf's acknowledgment of the guidance provided by the *Hochstrasser* and *Shilton* decisions and applied the test as formulated by Lord Radcliffe and Lord Templeman to conclude that a payment in lieu of notice, contractually agreed from the outset of the employment relationship, fell squarely within it.

17. In my view, the same approach should be adopted in the construction of section 8(1) of the Ordinance. Income chargeable under that section is likewise not confined to income earned in the course of employment but embraces payments made (in Lord Radcliffe's terms) "in return for acting as or being an employee", or (in Lord Templeman's terms) "as a reward for past services or as an inducement to enter into employment and provide future services". If a payment, viewed as a matter of substance and not merely of form[22] and without being "blinded by some formulae which the parties may have used",[23] is found to be derived from the taxpayer's employment in the abovementioned sense, it is assessable. This approach properly gives effect to the language of section 8(1).

18. It is worth emphasising that a payment which one concludes is "for something else" and thus not assessable, must be a payment which does not come within the test. As Lord Templeman pointed out, it is only where "an emolument is *not* paid as a reward for past services or as an inducement to enter into employment and provide future services but *is* paid for some other reason, [that] the emolument is not received 'from the employment'."[24] Thus, where a payment falls within the test, it is assessable and the fact that, as a matter of language, it may also be possible to describe the purpose of that payment in some other terms, eg, as "compensation for loss of office", does not displace liability to tax. The applicable test gives effect to the statutory language and other possible characterisations of the payment are beside the point if, applying the test, the payment is "from employment".

D.2 Whether a payment is or is not "from employment"

19. As the decided cases show, a variety of payments may fall outside the test. Thus, it is well-established that damages obtained in a suit for wrongful dismissal or a payment under a settlement agreement reached in such a suit are not regarded as income from employment.[25] Such a sum is properly regarded as deriving from a cause of action

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21 [1999] STC 803 at 807-808.

22 *Hochstrasser v Mayes* [1960] AC 376 at 390.

23 *Henley v Murray* (1950) 31 TC 351 at 365.

24 *Shilton v Wilmshurst* [1991] 1 AC 684 at 689 (emphasis supplied). See also *Henry v Foster* (1931) 16 TC 605 at 634, per Romer LJ, cited in Section D.2 below.

25 *Henley v Murray* (1950) 31 TC 351 at 363, 366-367; *Comptroller-General of Inland Revenue v Knight* [1973] AC 428 at 433.

arising after the contract has been discharged by breach.[26] To take another example, in the *Hochstrasser* case, the sum in question was a payment to indemnify an employee who had purchased a house under a housing scheme set up by the employer, but who had then had to sell it at a loss when directed by the employer to work elsewhere in the country. The indemnity was held not to come within the test. As Lord Radcliffe put it:

> "... the circumstance that brought about his entitlement to the money was not any services given by him but his personal embarrassment in having sold his house for a smaller sum than he had given for it. I regard the employer's payment as being in substance a free benefit conceded to the employee."[27]

20. Conversely, in many cases, there will be little doubt that a payment is assessable as "income from employment". This is so where, for instance, the sum is plainly an entitlement under the contract of employment, such as a lump sum stipulated to be payable in the event of early termination as in *Williams v Simmonds*[28] and *Dale v de Soissons*[29] or an amount paid pursuant to a clause enabling the employer to terminate by making a payment in lieu of notice as in *EMI Group Electronics v Coldicott*.[30]

21. Of particular relevance to the present appeal are a group of cases where the taxpayer's contention was that the payment fell outside the charge because it was not made in return for his acting as or being an employee but as consideration for abrogating his rights under the contract of employment. The operation of the test in that context is illustrated by the following decisions:

(a) In *Hunter v Dewhurst*,[31] a company chairman, Commander Dewhurst, would have been entitled under Article 109 of the company's articles to compensation for loss of office in a sum equal to his total remuneration in the preceding five years if he were to resign in stated circumstances. The company, however, negotiated an agreement whereby he would not resign, but would receive a much reduced salary and attend at work occasionally as a director. In consideration, the company paid him £10,000, the taxability of which was in dispute. The House of Lords held that such amount was in substance paid by the company to obtain a release from its contingent liability under Article 109 and was not assessable. Lord Atkin stated:

> "... a sum of money paid to obtain a release from a contingent liability under a contract of employment cannot be said to be

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26 The position regarding liquidated damages stipulated in a contract may well differ and I would keep that question open.

27 *Hochstrasser v Mayes* [1960] AC 376 at 392.

28 (1981) 55 TC 17.

29 (1950) 32 TC 118, discussed below.

30 [1999] STC 803.

31 *Hunter v Dewhurst* (1931) 16 TC 605 at 637.

> received 'under' the contract of employment, is not remuneration for services rendered or to be rendered under the contract of employment, and is not received 'from' the contract of employment".[32]

(b) In contrast, two other directors of the same company, Mr Arthur Foster and Mr Joseph Foster, each received compensation in accordance with Article 109 (and not under any agreement abrogating their rights thereunder). They were held liable to be taxed on those receipts under Schedule E. In the English Court of Appeal (their cases, unlike Commander Dewhurst's case, not having proceeded to the House of Lords), Lord Hanworth MR held that the payments represented deferred remuneration for services rendered and so were from their employment.[33] Lawrence LJ similarly concluded that each was "...a sum agreed to be paid in consideration of the Respondent accepting and serving in the office of director, and consequently ... a sum paid by way of remuneration for his services as director."[34] And, agreeing, Romer LJ stated as follows:

> "...article 109 expresses that the sum to be paid in the last year of office is to be compensation for loss of office. Now, do those words make any difference? In my opinion they do not. In the first place, it cannot matter what the parties call the money which is to be paid in the last year of office if one finds, as here, that the only consideration for the payment by the company of that sum is the service by the director and that it is a sum for which the director must be deemed to have stipulated when offering his services to the company and that it is paid to him by reason of his having performed those services."[35]

(c) In *Henley v Murray*,[36] the taxpayer was managing director of a company under an employment contract which was terminable at the earliest on 31 March 1944. The company paid him £2,202 14s 4d to leave on 6 July 1943, that amount being the equivalent of what he would have received if he had continued in his employment until 31 March 1944. However, such payment was not a matter provided for in his contract. The payment was held not to be assessable, Sir Raymond Evershed MR stating:

> "....it is also not open to the Crown to say that the sum of £2,000 odd constituted profits from the office or employment, since I

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32 At 645.
33 *Henry v Foster* (1931) 16 TC 605 at 630-631.
34 *Ibid* at 632.
35 *Ibid* at 634.
36 (1950) 31 TC 351.

> think upon its true analysis, it constituted the consideration payable to the taxpayer for the total abrogation imposed on him of his contract of employment, so that from 6 July 1943, no contract existed under which that figure or any other sum could be paid."[37]

Jenkins LJ put it thus:

> "...this sum can only be regarded on the facts of this case as paid to the taxpayer in consideration of his surrendering his right to serve on and be remunerated down to the end of his contractual engagement."[38]

(d) *Dale v de Soissons*[39] was a contrasting decision. The taxpayer, Colonel Pierre de Soissons, had signed a contract of employment which gave the employer the option of terminating at the end of the first or second year of its three-year term on payment of a stipulated amount. The employer exercised that option at the end of the first year and the taxpayer's liability to tax for the sum of £10,000 duly paid to him pursuant to that clause was in dispute. He argued that it was paid "for the cancellation of the rights under the agreement which [he] would otherwise have had".[40] This was rejected. Sir Raymond Evershed MR stated:

> "Cases of this kind, ... are never entirely easy, and in the last resort it seems to me to turn upon the short question ..., namely, whether following the language of the Rule this sum can be said to arise from the contract of employment."[41]

His Lordship held that the answer was in the affirmative, approving Roxburgh J's statement in the lower court to the following effect:

> "In the present case the taxpayer surrendered no rights. He got exactly what he was entitled to get under his contract of employment. Accordingly, the payment, in my judgment, falls within the taxable class ..."[42]

(e) In *Comptroller-General of Inland Revenue v Knight*,[43] the taxpayer was made redundant when his position was "Malayanised". He received a compensation payment which was not made pursuant to any term of his

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37 *Ibid* at 363.
38 *Ibid* at 368.
39 (1950) 32 TC 118.
40 At 127.
41 At 128.
42 *Ibid*.
43 [1973] AC 428 (PC).

contract nor under any express termination agreement. Lord Wilberforce, giving the advice of the Privy Council, concluded that the sum was not paid "in respect of" the taxpayer's employment but was made in consideration of abrogating his service agreement and so was not taxable.[44]

(f) Finally, in *Mairs v Haughey*,[45] the payment received by the taxpayer upon the privatisation of a shipyard in financial difficulties was held by the House of Lords to have had two elements, the first being compensation for abrogation of his rights under a pre-existing enhanced redundancy scheme (which compensation was not taxable) and the second being consideration for the taxpayer accepting employment on a new contract with the privatised owners (which was liable to tax).

22. In situations like those considered above, since the employment is brought to an end, it will often be plausible for an employee to assert that his employment rights have been "abrogated" and for him to attribute the payment received to such "abrogation", arguing for an exemption from tax. It may sometimes not be easy to decide whether such a submission should be accepted. However, the operative test must always be the test identified above, reflecting the statutory language: In the light of the terms on which the taxpayer was employed and the circumstances of the termination, is the sum in substance "income from employment"? Was it paid in return for his acting as or being an employee? Was it an entitlement earned as a result of past services or an entitlement accorded to him as an inducement to enter into the employment? If the answer is "Yes", the sum is taxable and it matters not that it might linguistically be acceptable also to refer to it as "compensation for loss of office" or something similar. On the other hand, the amount is not taxable if on a proper analysis the answer is "No". As the "abrogation" examples referred to above show, such a conclusion may be reached where the payment is not made pursuant to any entitlement under the employment contract but is made in consideration of the employee agreeing to surrender or forgo his pre-existing contractual rights. In the present appeal, the principal dispute between the taxpayer and the Revenue involves rival contentions along the aforesaid lines.

E. The taxpayer's contentions

E.1 The principal argument

23. As his main argument, Mr Barrie Barlow SC, appearing for the taxpayer, contended that Sums B and C fall outside the section 8 charge because they were not paid in accordance with the taxpayer's entitlements under the employment contract, but pursuant to the termination agreement in consideration of the abrogation of his contingent rights under the employment contract. In particular, so the argument runs, the taxpayer's rights to the two annual salaries and the average of the three previous years' bonuses under clause 9(c) of

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44 At 435.

45 [1994] 1 AC 303.

the employment contract were merely contingent so that Sums B and C did not represent payment of those entitlements. Sums B and C are therefore not income from the taxpayer's employment. Mr Barlow sought, in other words, to equate Mr Fuchs's circumstances to those of Commander Dewhurst[46] as opposed to those of Messrs Arthur and Joseph Foster;[47] and to those of Mr Henley[48] or Mr Knight[49] as opposed to those of Colonel de Soissons.[50]

24. In support of that argument, Mr Barlow relied heavily on the decision of the Court of Appeal in *CIR v Elliott*,[51] arguing that its approach to a contingent, un-accrued right ought to be applied in the present case. In *Elliott*, the taxpayer had a remuneration package which included his being immediately allotted 5 million units in an incentive compensation plan ("ICP") with a promise of further units to be credited to him depending on the progress of certain projects. Such ICP units would yield a stream of income. However, less than five months into his employment, the taxpayer was asked to resign and a termination agreement was entered into whereby US$11 million was paid to him by the employer in consideration of the cancellation of his participation in the ICP scheme. It was common ground that such part of that US$11 million sum as was attributable to the abrogation of his contingent right to be credited with ICP units in the future was not taxable. The controversy related to his existing ICP units. The Board of Review and the Judge both held that such units had been allotted to him as an inducement to take up the employment so that such part of the US$11 million as was paid in substitution for the income that he was entitled to by virtue of the existing ICP units was properly regarded as income from the taxpayer's employment. The Court of Appeal disagreed, Le Pichon JA holding that the Board and the Judge had misconstrued the scheme and that, properly understood, the rights under the existing ICP units were contingent on the taxpayer remaining in employment for at least five years and were not enforceable after cessation of his employment.[52] The payment he received therefore reflected no accrued entitlement upon termination of his employment. Emphasising the fact that the employment contract had been superseded by the termination agreement, her Ladyship concluded:

> "... the entire sum of the US$11 million constituted compensation for the abrogation of all of the taxpayer's rights in relation to the ICP units, existing as well as future, including the contingent right to a pro rata share of the relevant income. In substance, the contingent right was part and parcel of the 'whole bundle of rights' which was extinguished through the cancellation of the ICP units. In my view, no part of that sum attracts income tax because no part of it was paid to the taxpayer 'in return for acting as or being an employee': the whole sum was to compensate the taxpayer for his loss of the ICP units."[53]

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46 In *Hunter v Dewhurst* (1931) 16 TC 605 at 637.
47 In *Henry v Foster* (1931) 16 TC 605.
48 In *Henley v Murray* (1950) 31 TC 351.
49 In *Comptroller-General of Inland Revenue v Knight* [1973] AC 428.
50 In *Dale v de Sissons* (1950) 32 TC 118.
51 [2007] HKLRD 297.
52 At §24.
53 At §30.

25. I am unable to accept the taxpayer's argument. In my view, unlike the situation held to exist in *Elliott*, Mr Fuch's rights under clause 9(c)[54] were not contingent in any material sense.

(a) Mr Barlow endeavoured to argue that the taxpayer's rights under clause 9(c) were contingent because they would only accrue if the taxpayer's employment was terminated without cause and because (under clause 4) payment of bonuses was discretionary and expressly contingent on HVB's operating results and the taxpayer's individual performance.

(b) However, the assessment was only raised because the taxpayer had received Sums B and C upon termination of his employment, being sums stated in the termination agreement to represent two annual salaries and the average of bonuses paid to the taxpayer in the previous three years, reflecting the terms of clause 9(c).

(c) Once HVB exercised its option to terminate under clause 9(c), the taxpayer acquired an accrued right to be compensated in accordance with the terms of that clause. There was nothing contingent about that entitlement. Mr Fuchs's annual salary was known, so his right to twice that amount was certain. That he had in fact been paid a bonus in each of the three previous years was also known and the average could be calculated with certainty. If it had happened that no bonus was paid in one or more of those years, there would still not have been anything uncertain or contingent about his entitlement to the average amount of such bonuses as had been paid (if any).

(d) The rights that accrued to the taxpayer under clause 9(c) upon termination were obviously enforceable at law. He could have sued to recover those sums if, for any reason, HVB had failed to make payment. *CIR v Elliott* is wholly distinguishable.

(e) Being given a right to substantial compensation in the event of early termination without cause was plainly an important part of the contractual consideration and self-evidently an inducement for Mr Fuchs to sign the employment contract.

26. It follows, in my view, that Sums B and C were paid in satisfaction of the rights which had accrued to the taxpayer under clause 9(c) and were plainly amounts derived "from his employment". They were not sums paid in consideration of the abrogation of the taxpayer's rights under the employment contract. Like Colonel de Soissons,[55] Mr Fuchs surrendered no rights. Instead, by negotiation, he augmented his clause 9(c) rights by securing an additional year's salary represented by Sum A. Sums B and C accordingly come

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54 Set out in Section B.1 above.

55 In *Dale v de Sissons* (1950) 32 TC 118.

within the charge to salaries tax contained in section 8(1). This conclusion is reached on reasoning which proceeds much along the lines of the Court of Appeal's approach.

27. In the course of his submissions, Mr Barlow also characterised Sums B and C as a "payment for early termination without cause" and as a "redundancy payment". For the reasons set out in Section D.1 above, it is my view that such characterisations are of no legal significance once the conclusion has been reached that the sums in question were in substance income deriving from the taxpayer's employment and so within the charge to salaries tax. I will therefore say no more about those submissions.

E.2 The apportionment argument

28. The fall-back position urged by the taxpayer in the event that Sums B and C are held to be income from his employment is that those amounts should be treated as income attributable to the entire 29 years of his service with HVB and not just to the two years worked in Hong Kong under the employment contract. It follows, so Mr Barlow submitted, that the sums should be apportioned so that 27/29th parts of Sums B and C are excluded from the charge by virtue of section 8(1A)(ii)[56] as representing income "derived from services rendered by a person who ... render[ed] outside Hong Kong all the services in connection with his employment" during the 27 year period preceding the start of his Hong Kong employment.

29. Essential to this argument is Mr Barlow's contention that Mr Fuchs was throughout employed under a single contract of employment with HVB, preserving and building up his entitlement to severance pay under German law over the entire 29 year period. The suggestion is that payment of Sums B and C represents satisfaction of that severance pay entitlement earned under the global contract which was performed, save for the last two years, outside of Hong Kong, making apportionment under section 8(1A) mandatory.

30. The apportionment argument is in my view wholly untenable. It was rightly rejected by the Assessor, the Deputy Commissioner, Burrell J and the Court of Appeal. It flies in the face of the express provisions of the employment contract and postulates terms of which no trace can be found in that agreement.

(a) The employment contract expressly became effective on 1 January 2004 and was for a term of three years, with any extension being a matter for negotiation.[57] If it was not extended, it could be terminated upon expiry of its stated term.[58] It says nothing about the 27 years of service rendered by the taxpayer before its commencement date.

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56 Set out in Section A above.

57 Clauses 1 and 3.

58 Clause 9(a).

(b) The employment contract also expressly provides that the agreement and the rights and obligations of the parties thereto "are, in all respects governed and construed in accordance with the laws of The Hong Kong Special Administrative Region".[59] It plainly applies Hong Kong law not only to the construction of its terms (as Mr Barlow sought to suggest) but to all the rights and obligations of the parties, including any statutory rights to severance pay. It certainly makes no mention of any entitlement to severance pay built up over the years under German law. The termination agreement is to like effect, providing that:

> "Judgement of this Termination of Employment and any disputes of a material or formal nature, which may arise shall be governed in accordance with the laws of The Hong Kong Special Administrative Region."[60]

(c) Mr Barlow sought to rely on the final sentence in clause 9(c) which states: "Any possible mandatory severance payments are included in the above mentioned compensation sum." But all that means is that Mr Fuchs could not expect to be paid any mandatory severance payments required under Hong Kong law in addition to the benefits conferred by clause 9(c).

(d) The contract dated 30 October 2000 signed by Mr Fuchs and HVB on his taking up employment in Singapore was adduced in evidence. It was for a term of three years, subject to being extended, and was governed by Singapore law. This shows that a series of separate contracts each with its own proper law were entered into with HVB and falsifies the suggestion that there was only one global contract. Significantly, by its clause 10 d) the Singapore contract provided: "... your original joining date with [HVB] Munich - September 1 1976 will be taken into account for calculating the severance package." No such provision exists in the employment contract.

(e) In any event, as the courts below held, there is simply no evidence of any entitlement accruing to the taxpayer under German law and so no basis for attributing payment of Sums B and C to satisfying any such entitlement.

F. Conclusion

31. For the foregoing reasons, I would dismiss the appeal. The parties indicated at the hearing that in the event that the appeal was either wholly allowed or wholly dismissed, costs should follow the event. Accordingly, I would order the taxpayer to pay the costs of this appeal.

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[59] Final clause.

[60] Clause 12.

Mr Justice Mortimer NPJ :

32. I have had the advantage of reading the judgment of Mr Justice Ribeiro PJ in draft and I fully agree with the decision and the reasons given.

Lord Walker of Gestingthorpe NPJ :

33. I agree with the judgment of Mr Justice Ribeiro PJ.

Mr Justice Bokhary PJ :

34. The Court unanimously dismisses the appeal with costs.

(Kemal Bokhary) Permanent Judge	(Patrick Chan) Permanent Judge	(RAV Ribeiro) Permanent Judge

(Mr Justice Mortimer) Non-Permanent Judge	(Lord Walker of Gestingthorpe) Non-Permanent Judge

Mr Barrie Barlow SC (instructed by Messrs Gall) for the appellant

Mr Benjamin Yu SC and Ms Yvonne Cheng (instructed by the Department of Justice) for the respondent