HCIA5/2003

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE

INLAND REVENUE APPEAL NO.5 OF 2003

BETWEEN

THE COMMISSIONER OF INLAND REVENUE Appellant

and

YUNG TSE KWONG Respondent

Before : Hon Tang J in Court
Date of Hearing : 19 July 2004
Date of Judgment : 30 July 2004

J U D G M E N T

---

1. The employment of the Taxpayer was evidenced by a letter dated 15 February 1999 ("Employment Letter"). Under the Employment Letter, he was entitled to a base salary as well as stock options. The Employment Letter went on to provide:

> "… Finally, as an 'insurance policy for peace-of-mind' if you should be terminated from your assignment as President — ACNielsen Media International for other than 'cause', we will reassign you to another ACNielsen opportunity or offer you severance pay for 12 months equal to your base salary at the time in accordance with our Career Transition Plan."

This 12-months severance pay was referred to in the Board of Review as Sum A. This appeal is not concerned with Sum B.

2. The Taxpayer's employment was terminated by a letter dated 12 January 2001 ("Termination Letter"). The Taxpayer was not offered reassignment, instead, he was offered Sum A. The Termination Letter stated:

> "As part of the Career Transition Plan, you are required to sign the attached 'Severance Agreement and Release'."

3. The Severance Agreement and Release dated 2 February 2001 ("Severance Agreement") was duly signed. By the Severance Agreement, the Taxpayer agreed to certain restrictive covenants. Clauses 3 to 7. As an example, Clause 4 provided:

> "… Employee also agrees that until the Benefit End Date Employee will not recruit or solicit any customers of the Company to become customers of any business entity which competes with any of the businesses owned or operated by the Company. In addition, Employee agrees that until the Benefit End Date neither Employee nor any company or entity Employee controls or manages, shall recruit or solicit any employee of the Company to become an employee of any business entity."

The Benefit End Date for the purpose of this appeal was the end of 12 months.

4. Clause 8 of the Severance Agreement provided:

> "… that in the event of any breach of the covenants contained in paragraphs 3, 4, 5, 6 or 7 in addition to any remedies that may be available to the Company, the Company may cease all payments required to be made to Employee under the Plan and recover all such payments previously made to Employee pursuant to the Plan. The parties agree that any such breach would cause injury to the Company which cannot reasonably or adequately be quantified and that such relief does not constitute in any way a penalty or a forfeiture."

5. Clause 11 of the Severance Agreement should be noted:

"11. Employee acknowledges that (a) Employee has been advised to consult with an attorney at Employee's own expense before executing this Agreement and that Employee has been advised by an attorney or has knowingly waived Employee's right to do so, (b) Employee has had a period of at least twenty-one (21) days within which to consider this Agreement, (c) Employee has a period of seven (7) days from the date that Employee signs this Agreement within which to revoke it and that this Agreement will not become effective or enforceable until the expiration of this seven (7) days revocation period, (d) Employee fully understands the terms and contents of this Agreement and freely, voluntarily, knowingly and without coercion enters into this Agreement, (e) Employee is receiving greater consideration hereunder than Employee would receive had Employee not signed this Agreement and that the consideration hereunder is given in exchange for all of the provisions hereof and (f) the waiver or release by Employee of rights or claims Employee may have under Title VII of the Civil Rights Act of 1964. The Employee Retirement Income Security Act of 1974, the Age Discrimination in Employment Act of 1967, the Older Workers Benefit Protection Act, the Fair Labor Standards Act, the Americans with Disabilities Act, the Rehabilitation Act, the Worker Adjustment and Retraining Act (all as amended) and/or any other local, state or federal law dealing with employment or the termination thereof is knowing and voluntary and, accordingly, that it shall be a breach of this Agreement to institute any action or to recover any damages that would be in conflict with or contrary to this acknowledgement or the releases Employee has granted hereunder. Employee understands and agrees that the Company's payment of money and other benefits to Employee and Employee's signing of this Agreement does not in any way indicate that Employee has any viable claims against the Company or that the Company admits any liability whatsoever."

6. Clause 12 of the Severance Agreement provided:

"This Agreement constitutes the entire agreement of the parties and all prior negotiations or representations are merged herein…. In addition, this Agreement supersedes any prior employment or compensation agreement, whether written, oral or implied in law or implied in fact between Employee and the Company, other than those contracts and agreements accepted from the application of section 5.8 of the Plan pursuant to the terms of such section, which prior agreements are hereby terminated."

7. Clause 14 provided:

> "That the Agreement shall be construed in accordance with the laws of the State of Illinois, except to the extent superseded by applicable federal law."

8. The issue before the Board of Review was whether Sum A was taxable under section 8(1A). According to the Commissioner, the severance payment was taxable because it was in the nature of a payment which induced an employee to enter into employment and provide future services.

9. However, the Taxpayer contended that Sum A was not taxable because it was paid as consideration for the restrictive covenants.

10. The Taxpayer relied on the case of *Beak (Inspector of Taxes) v. Robson* [1943] 1 All ER 46. There, the taxpayer was employed under a contract of employment for five years as director and manager. The agreement contained clauses under which, in the event of determination, he covenanted for a certain period not, without the consent of the company, to be engaged or interested in the business of a coal exporter within a radius of 50 miles of Newcastle-upon-Tyne. The taxpayer was paid £7,000 by the company on the execution of the agreement in consideration of the respondent entering into that covenant. It was contended on behalf of the revenue that the £7,000 was remuneration from his office as director and manager and accordingly taxable under the Income Tax Act 1918, Schedule E. It was held at first instance, in the Court of Appeal and then finally in the House of Lords, confirming the decision of the Commissioners that the £7,000 was not taxable. At p.47D, Viscount Simon, LC, said:

> "… In the agreement before us, the obligations flowing from the contract of service and the remuneration to be received by the respondent in respect of that service are entirely separate from the restrictive covenant and the consideration which is given for it. The sum of £7,000 is not paid for anything done in performing the services in respect of which Robson is chargeable under Sched. E. The consideration which he has to give under the covenant is to be given not during the period of his employment, but after its termination. He is giving to the company for a sum of £7,000 the benefit of a covenant which will only come into effect when the service is concluded. I agree with the Court of Appeal in the view that to treat this £7,000 as a profit arising from the respondent' s office is to ignore the real nature of the transaction. It is quite true that, if he had not entered into the agreement to serve as a director and manager, he would not have received £7,000. But that is not the same thing as saying that the £7,000 is profit from his office of director so as to attract tax under Sched. E.
>
> The Attorney-General points out that it is not uncommon in managerial agreements to include the covenant not to compete after the service is terminated without any separate consideration being allocated to the covenant, and it was suggested that a decision in favour of the respondent in this case might involve the apportionment of the remuneration which a manager receives under his agreement between the profit

> of his office and the price paid to secure the covenant. I propose to say nothing about that, and to decide the present case purely upon the terms of the agreement of Oct. 4, 1937. That agreement is admitted to be a *bona fide* contract and, so regarded, the £7,000 cannot properly be treated as a profit arising from the respondent's office or employment."

11. So the issue before the Board was, what was the real nature of the transaction? Was Sum A given in return for the restrictive covenants? Or was it an inducement to the Taxpayer to enter into the employment? Or partly the one, and partly the other. This is essentially a question of fact.

12. Ms Yvonne Cheng who appeared for the Commissioner submitted that there was no evidence on the content of the Career Transition Plan. The Taxpayer who gave evidence was unable to shed any light on it. She contended that Sum A was an inducement to enter into employment and nothing else. So Sum A was liable to tax.

13. The evidence on the point are the Employment Letter, the Termination Letter and the Severance Agreement. There is no evidence that they were not arm's length agreements.

14. I think on such evidence, it was open to a tribunal to find that Sum A would only be paid in accordance with the provisions of the Career Transition Plan, that the Career Transition Plan required the signing of the Severance Agreement, and that the Severance Agreement regulated the payment and possible re-payment of Sum A. I have no reason to believe the taxpayer would have entered into the Severance Agreement if he was entitled to be paid otherwise. It was not the Commissioner's case that Sum B was the reason for the Severance Agreement.

15. Having regard to such evidence, it was a question of fact whether the entire Sum A was attributable to the giving of the restrictive covenants. The Severance Agreement expressly provided that the Severance Agreement was made "in consideration of the mutual covenants and promises hereinafter provided and of the actions taken pursuant thereto, …". See Clause 12 quoted in para. 6 above. Clause 11 gave the taxpayer the right to revoke the Severance Agreement within seven days from the signing of the Severance Agreement.

16. Of course, the Board was not bound by the label which the parties had chosen to put on the payment but must consider the true nature of the payment. In the circumstances of this case, I believe it was open to the Board to find that Sum A was paid for the restrictive covenants and nothing else. I say this having regard to the nature of his employer's business and the fact that he was employed as "President — ACNielsen Media International and Managing Director — Regional Client Development for Asia Pacific". It must be of real value to his employer that "he will not recruit or solicit any customers of the Company to become customers of any business entity which competes with any of the businesses owned or operated by the Company nor, shall recruit or solicit any employee of the Company to become an employee of any business entity" Clause 4. So

from the point of view of the employer, it was possible that the sole consideration for the payment was the restrictive covenants.

17. As noted, the Severance Agreement was to "be construed in accordance with the law of the State of Illinois, except to the extent superseded by applicable federal law". I have already noted Clause 11 of the Severance Agreement in para. 5 above. It seems that the rights and obligations of the taxpayer and its employer were governed "by the law of the State of Illinois" and possibly the federal law of the United States of America. No evidence of any such law was put before me. The burden is on the taxpayer to produce such evidence, if they were relevant. It may be that under such law, the Severance Agreement had to be "the entire agreement", or that the sole consideration for Sum A had to be the Severance Agreement. I do not know. I have to proceed on the basis of the evidence before me. Of course, my decision is not binding on the employer and would not affect their position.

18. As for the Taxpayer employee, he was not bound to give the restrictive covenants. No doubt, he would assess his position upon termination and decide whether it was advantageous to him to agree to such terms. If not, no doubt he would refuse the offer. So from his point of view, by the time he accepted Sum A, it was entirely possible that he regarded the Severance Agreement to be the only consideration for the payment.

19. On the other hand, having regard to the reference to "insurance policy for peace-of-mind" in the Employment Letter, it was also possible for one to find that the severance payment or its alternative, reassignment, provided the security which operated as an inducement to enter into employment.

20. Finding of facts are for the Board of review. Unless a finding of fact is shown to be erroneous I cannot interfere.

21. The majority of the Board of Review dealt with the matter in para. 27 of the Case Stated:

> "The Board is however divided as to whether Sum A is 'income derived from services rendered in Hong Kong'. The majority of the Board takes the view that under the Letter of Appointment, Sum A is only payable if 2 conditions are satisfied. First, there must be a termination of the Taxpayer's assignment as President of ACNielsen Media International. Secondly, there must not be any reassignment of the Taxpayer within the ACNielsen Group. The entitlement of Sum A is therefore wholly dependent on cessation of the Taxpayer's connection with ACNielsen. Whilst these are conditions precedent leading to the entitlement of Sum A, they do not suggest that services rendered in the past formed part of the consideration for Sum A. The Letter of Appointment further provides that Sum A is to be paid *'in accordance without Career Transition Plan'*. As indicated by the Letter of

> Termination, the Severance Agreement and Release is '*part of the Career Transition* Plan'. It follows that the covenants in the Severance Agreement and Release formed part of the bargain in return for Sum A. The relevant covenants restrict the activities of the Taxpayer and prevent his from instituting proceedings against ACNielsen Group. They do not impose any obligation on the part of Taxpayer to render any service in favour of ACNielsen. The majority of the Board therefore finds in favour of the Taxpayer."

22. I have found the paragraph difficult. It is correct that Sum A would not be payable unless the employment was terminated and no reassignment offered, but the more pertinent question was, whether the Sum A was an inducement to the taxpayer entering into employment. Was it for the employee's peace-of-mind, in other words, to protect the taxpayer against sudden unemployment. If so, it was capable of being an inducement to him to enter into employment. This is a factual issue and it was for the Board to decide. But it has not been expressly dealt with by the Board.

23. Nor could the statement that "It follows that the covenants in the Severance Agreement and Release *formed part* of the bargain in return for Sum A" (my emphasis) be regarded as an implied rejection of Sum A as an inducement to enter into employment being also *in part* a consideration for Sum A.

24. Earlier, in para. 16 of the case stated, the Board said:

> "The Revenue conceded that the Taxpayer's case does not fall within the basic charge of section 8(1) but falls to be considered under section 8(1A)(a). We are of the view that this is a crucial concession. Sum A is only taxable if it constitutes 'income derived from services rendered in Hong Kong'."

25. Insofar as the Taxpayer's case depended on section 8(1A)(a), it is correct that Sum A was only taxable if it constituted 'income derived from services rendered in Hong Kong'. But the finding in para. 27 that because the covenant in the Severance Agreement "do not impose any obligation on the part of the Taxpayer to render any service in favour of ACNielsen", Sum A was not taxable under section 8(1A)(a), did not address the Commissioner's argument that he was seeking to tax Sum A as an inducement to enter into employment, and not as payment for the restrictive covenants.

26. I believe the real question is whether the restrictive covenants were the only reason for the payment of Sum A. That question of course is not answered simply by asking whether the restrictive covenants required any services to be rendered in Hong Kong. If the Severance Agreement required services to be performed in Hong Kong in return for Sum A, then section 8(1A)(a) would render such payment taxable. But the fact that the Severance Agreement did not require any services to be performed in Hong Kong would only render payment for the Severance

Agreement not taxable. But it did not answer the question whether the entire severance pay was attributable to the Severance Agreement. Rather, if the correct answer is that Sum A was paid partly as "insurance policy for peace-of-mind", supposing that to be an inducement to enter into the employment, then the amount attributable to that element would be taxable because it would be paid for services rendered, part of which services were rendered in Hong Kong.

27. So with respect, I believe the approach adopted by the majority is unsatisfactory.

28. Ms Cheng further submitted that there was another flaw. She said that it is not correct to describe no offer of reassignment as a condition precedent, she submitted the reassignment was an alternative to the offer of Sum A. It was open to the employer to decide whether to offer reassignment or severance pay. That is so. But I do not believe that mattered to the decision of the majority.

29. Mr Ho who appeared for the Taxpayer submitted that contractual severance pay is not taxable and he referred me to the case of *Mairs v. Haughey* [1994] 1 AC 303.

30. There, the taxpayer was employed by a publicly-owned firm of shipbuilders as a construction manager. He enjoyed contingent rights in a non-statutory enhanced redundancy scheme. As part of a scheme for the privatization of the firm, the taxpayer was to be transferred to the operating subsidiary on new terms and conditions of employment. Under the new terms and conditions, the taxpayer would give up his rights under the enhanced redundancy scheme, which the operating subsidiary could not afford to maintain. The taxpayer would be paid 30% of the amount that he would have received under the scheme had he been made redundant on 1 September 1989, and the balance if he were made redundant within two years thereafter. The taxpayer was paid £4,506 ("element A") representing the 30%. Subsequently he was paid an additional £1,300 ("element B"), which was related to years of service. The taxpayer was assessed to income tax under Schedule E in relation to the entire sum of £5,806. On appeal to the commissioners, it was held that element A was not taxable because it was compensation for the loss of his contingent rights under the enhanced redundancy scheme but that element B was taxable as an emolument from employment on the ground that it had been paid as consideration for the acceptance by the taxpayer of the new terms and conditions and thus an inducement to enter into employment with the operating subsidiary. As an aside, I should mention that *Mairs v. Haughey* is clear authority that payment made as an inducement to enter into employment is taxable, and that it does not matter whether it was paid before, during or on termination of the employment.

31. The Revenue appealed and initially there was a cross-appeal by the taxpayer in relation to element B which was not pursued. At p.318, Lord Woolf said:

> "… I am quite satisfied that the special commissioner and the Court of Appeal were right to conclude that this was not a situation where the aggregate sum, consisting of

> the two elements, should be regarded as being paid as an inducement to the employees to become or remain employed by (the subsidiaries) …
>
> … However, as was accepted by Mr Coghlin, if the payments were being paid for two considerations, the special commissioner was entitled to apportion the payments between the considerations (as to which see *Tilley v. Wales* [1943] A.C. 386), and, this being so, it cannot be said that the apportionment adopted was wrong. …"

Lord Woolf went on to deal with what he regarded as the important issue, namely, whether a cash payment made for giving up non-statutory contingent redundancy rights is received by an employee as an emolument from his employment and therefore chargeable to income tax. At p.320, he came to the conclusion that it was not taxable, and he explained why:

> "… A redundancy payment has therefore a real element of compensating or relieving an employee for the consequences of his not being able to continue to earn a living in his former employment. The redundancy legislation reflects an appreciation that an employee who has remained in employment for the minimum time has a stake in his employment which justifies his receiving compensation if he loses that stake. It is distinct from the damages to which he would be entitled if his employment were terminated unlawfully. It is also unlike a deferred payment of wages in that the entitlement to a redundancy payment is never more than a contingent entitlement, which no doubt both the employer and employee normally hope will never accrue."

So, *Mairs v. Haughey* was a decision on the special nature of redundancy payment as compensation for the employee' s stake in his employment. Here, I am not dealing with redundancy payments.

32. *Dale v. de Soissons* [1950] 2 All ER 460 is a case which is closer to the present one. There a service agreement provided that a company should be entitled to terminate the taxpayer' s appointment at the end of the first or second year of the three years covered by the agreement by three months notice, whereupon a lump sum would become payable to the Taxpayer by way of compensation for loss of office.

33. It was held by the Court of Appeal that since the taxpayer was entitled, under the terms of the service agreement, to receive a payment of compensation in the event, which happened, of the company electing to terminate the agreement, the compensation was a profit arising from his employment, and therefore taxable. As Sir Raymond Evershed MR put it, at p.462, the payment:

> "… was part of the remuneration which the taxpayer was entitled to get under, and received from, his contract of service. The contract provided that he should serve either for three years at an annual sum or, if the company so elected, for a shorter

> period of two years or of one year at the annual sum in respect of the two years or the one year, as the case might be, plus a further sum, that is to say, the £10,000 was something to which he became entitled as part of the terms on which he promised to serve, something which he was entitled to received in the particular event specified, namely, the term not running the three years but being earlier determined. So that it is as much a payment received for services rendered as the monthly salaries paid during the course of employment."

34. Mr Ho also referred to the case of *Hochstrasser (Inspector of Taxes) v. Mayes* [1960] AC 376. The case was concerned with a sum of £3,500 paid by ICI to the taxpayer for his loss when on his transfer to another factory he sold the house which he purchased pursuant to ICI' s housing scheme. It was held in that case that the payment was compensation for the taxpayer' s actual loss and it was not taxable. I do not believe this decision assists the taxpayer.

35. Another case relied on by Mr Ho is the case of *Pritchard (Inspector of Taxes) v. Arundale* [1972] 1 Ch. 229. This is a rather difficult case, and as explained by Lord Templeman it turned on its own peculiar facts. See *Shilton v. Wilmshurst (Inspector of Taxes)* [1991] 1 AC 684 at 691F:

> "*Pritchard v. Arundale* [1972] Ch. 229 was a case dealing with a prospective employee. A senior partner in a firm of chartered accountants agreed to leave his firm and serve a company as managing director on terms, inter alia, that 4,000 shares in the company would be transferred to him by a shareholder. The Crown claimed that the 4,000 shares constituted an emolument from the employment. The taxpayer claimed that the shares were an inducement to him to give up an established position and status and to compensate him for doing so. The commissioners accepted this claim and held that the transfer of shares was not something in the nature of a reward for his future services with the company. Megarry J. held that there was ample evidence on which the commissioners could reach their conclusion."

36. There, the taxpayer was a senior partner in a firm of chartered accountants. He was invited by L to join a company as a whole-time managing director for seven years. He was unwilling to do so because it would involve abandoning his private practice. But eventually he agreed when it was provided that in consideration of his agreeing to serve the company 4,000 shares in the company would be transferred to him forthwith by L. It was argued on behalf of the taxpayer that the shares were given as:

> "… an inducement to the taxpayer to give up his established position and status in the firm of which he was a senior partner and to compensate him for the loss of that position and status. …"

37. The Commissioners held in his favour and found that the transfer of the shares "although connected with his proposed employment with the company, was not something in the nature of a reward for his future services therewith". As Lord Templeman explained it was paid to him as compensation not for joining the company but for giving up his established position. It was a decision who turned its own facts.

38. In *Shilton v. Wilmshurst (Inspector of Taxes)* [1991] 1 AC 684, the taxpayer, a professional footballer, was employed by Nottingham Forest Football Club under a contract due to expire in July 1983. In July 1982, the club accepted an offer from Southampton Football Club, subject to agreement by the taxpayer, for the transfer of the taxpayer for a fee of £325,000. The taxpayer agreed to sign on to play for Southampton on payment being made to him by Nottingham Forest of a lump sum of £75,000. He then entered into a new contract of employment with Southampton Football Club.

39. The issue there was whether the £75,000 was taxable under Schedule E, and it was held by the House of Lords allowing the appeal that an emolument was chargeable to Schedule E as being "from" employment if the payment in question had been made to the taxpayer as a reward for past services or as an inducement for him to agree to become, or to remain, an employee; and that in relation to such payment by third parties, it was not necessary to show that the person making the payment had any interest in the performance of the services to be undertaken by the employee under his contract of employment. And that since the payment of £75,000 had been made to, and accepted by, the taxpayer in return for his agreeing to become an employee of Southampton and for no other reason, there was accordingly an emolument from his employment with that club chargeable to tax. Lord Templeman said at p.689E:

> "…. 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' ."

Again, this decision went to the question, which was one of fact, what was the reason(s) for the payment sought to be taxed.

40. These authorities confirm my view that the crux of the matter is whether Sum A was paid solely or partly as an inducement to enter into employment or was it solely or partly for the making of the Severance Agreement and in particular the giving of the restrictive covenants.

41. I turn to deal with the questions raised.

42. Question (a): Whether the majority of the Board was wrong to conclude on the evidence that services rendered in the past did not form part of the consideration for Sum A.

43. I am not sure that the majority of the Board actually so held. See para. 27 of the Case Stated. I refer to para. 21-26 of this decision.

44. Question (b): Whether by its conclusion the majority of the Board wrongly failed to take into account the evidence that Sum A was payable pursuant to the Letter of Appointment which contained an offer of employment by ACNielsen Corporation to the Taxpayer.

45. I do not believe the Board had asked itself whether any part of Sum A was paid as an inducement to enter into employment.

46. Question (c): Whether the majority of the Board ought instead to have inferred and concluded that:-

(i) the terms of employment (including the payment of Sum A on the happening of certain contingencies) proposed in the Letter of Appointment must have acted as an inducement to the Taxpayer (who accepted such terms) to render services as an employee of ACNielsen Corporation;

(ii) insofar as such services were partly rendered in Hong Kong, a corresponding proportion of Sum A should accordingly be chargeable to salaries tax under sections 81(A) and 9 of the Ordinance; and

(iii) the subsequent issue of the Letter of Termination by ACNielsen Corporation and the execution of the Severance Agreement and Release by the Taxpayer could not in law affect the chargeability of such proportion of Sum A to salaries tax.

47. The answers to Question (c) are:

(i) This is a question of fact for the Board. However, I do not believe the Board had considered the possibility that Sum A was an inducement to enter into employment. The statement in para. 27 the Case Stated is unsatisfactory for the reasons explained in paras. 21-26 above.

(ii) If Sum A or part thereof was an inducement, then the answer is "Yes".

(iii) But if the signing of the Severance Agreement was a consideration for the payment of Sum A, that is no reason why that should not affect the chargeability of Sum A to salaries tax. Indeed, quite the contrary. So much of Sum A which is attributable to the Severance Agreement is not taxable since no service was required to be performed in Hong Kong by the taxpayer.

48. Question (d): In light of the answers to questions (a) to (c), whether part and (if so) what part of Sum A was income chargeable to salaries tax under sections 8(1A) and 9 of the Ordinance as income derived from services rendered in Hong Kong.

49. I was asked by the parties, if possible, to deal with the matter rather than to refer the matter back to the Board of Review. But for the fact that this appeal involves a relatively small sum of money, I would have been reluctant to do so. I believe the Board of Review is best able to deal with the question, which is a question of fact.

50. I turn to consider the minority view:

> "28. The minority of the Board takes the view that 3 reasons led to the payment of Sum A: satisfactory services rendered by the Taxpayer resulting in the absence of any termination for cause; the lack of alternative employment and the entry into the restrictive covenants. The minority therefore reckons that Sum A should be divided into three parts with a third thereof being allocated to services rendered. The minority would have directed that the Taxpayer be taxed on such part of the aliquot third that is attributable to the days that he rendered services in Hong Kong prior to the termination of the Taxpayer's employment."

51. The minority would attribute one-third of Sum A to services rendered. However, it did so on the basis that there were three reasons which led to the payment of Sum A. I find it difficult to agree that there were really three reasons for the payment of Sum A or that that should be the basis of apportionment.

52. So far I have used Sum A as a shorthand. It is necessary now to look more closely at what was the "insurance policy for peace-of-mind". It was the offer of reassignment or Sum A at the option of employer (the offer). Thus, if there was any inducement to enter into employment, it was not Sum A, but the offer. Suppose, reassignment was offered, does it mean part of the remuneration for the reassigned job would be liable to tax because the possibility of reassignment was an inducement to enter into the original employment? The remuneration on reassignment is unlikely to be taxed as an inducement to enter into the original employment if it was appropriate for the new job. Nor should one forget that the taxpayer was entitled to refuse the offer, whether it be reassignment or Sum A. So what is taxable is the value of the offer to the taxpayer as an inducement and not Sum A itself. It is not easy to put a monetary value on the offer. The value of the offer is uncertain. There are many variables, e.g. the length of the actual employment. The longer the employment the greater the chance that the employee would leave of his own accord, in which event, there would be no reassignment or Sum A. Also, the more likely the employee would refuse to enter into the restrictive covenants. So if one had asked the parties at the time of the Employment Letter how much was the offer worth as an inducement, I think they would be hard put to provide an answer. It would depend on many variables.

53. But I think the offer was an inducement. After all, the offer was referred to in the Employment Letter as "insurance policy for peace-of-mind". Secondly, it seems that there was little discussion with the Taxpayer about the Career Transition Plan. For all we know, the Taxpayer was unaware at the time of the Employment Letter that Sum A would come with strings attached.

54. I have been asked to apportion Sum A. Essentially, I need to put a value on the offer as the inducement. Doing the best I can, I have come to the conclusion that to apportion 10% of Sum A as the inducement to enter into employment is reasonable. I do so because of the nature of the employer's business, the taxpayer's position in that business and the length of his service. I also have regard to the terms of the Severance Agreement. It was the taxpayer's acceptable of the Severance Agreement which resulted in the payment. I think I am entitled to say that at least by the time the taxpayer had to decide whether to accept Sum A, the acceptability of the Restrictive Covenants would have been the dominant consideration. Nor is it clear at what time should the value of the offer be taken. Its value might be highest at the time of the Employment Letter. But I do not think it is right to value the offer as at that date. Because Sum A might never be offered; the taxpayer might leave of his own accord; or reassignment was offered on terms no more advantageous to the taxpayer. Also by the time Sum A was offered and accepted, it might be unreal to try to assess what the offer was worth as the inducement to enter into the employment. So what I think I should do is to put a value on the offer having regard to all the circumstances from the Employment Letter to the actual payment of Sum A. I do not pretend that my approach is scientific or entirely logical. This kind of question is best decided by the Board of Review with its special experience. From which, rightly, there is no appeal. But since the parties wish me to undertake the task, doing the best I can, I have decided that one-tenth of Sum A should be liable to salaries tax. It is common ground that it is subject to a further apportionment depending on the number of days service performed in Hong Kong during the taxpayer's employment.

55. The parties have indicated that they wish to deal with the question of costs after my decision. I invite them to make their submissions within 14 days if they cannot agree on the order.

(Robert Tang)
Judge of the Court of First Instance
High Court

Ms Yvonne Cheng, instructed by Department of Justice, for the Appellant.

Mr Ho Chi Ming, instructed by Messrs Yaddy Cheung & Co., for the Respondent.