CACV 7/2008

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF APPEAL

CIVIL APPEAL NO. 7 OF 2008
(ON APPEAL FROM HCIA NO. 1 OF 2007)

BETWEEN

COMMISSIONER OF INLAND REVENUE Appellant

and

TSAI GE WAH Respondent

Before: Hon Rogers VP, Lam and Barma JJ in Court
Date of Hearing: 25 September 2008
Date of Handing Down Judgment: 21 November 2008

J U D G M E N T

Hon Rogers VP:

1. This was an appeal from a judgment of Reyes J given on 5 November 2007. The matter before the judge was an appeal by the Commissioner by way of case stated from a decision

of the Board of Review whereby it had reduced the net assessable income for the purposes of the salaries tax assessment of the taxpayer for the year 2003/04 by the amount of $103,196. At the request of the Commissioner the Board had stated four questions. The judge dealt with each question separately and answered each question in the negative holding against the submissions of the Commissioner. At the conclusion of the hearing of this appeal judgment was reserved which we now give.

2. Before considering the issues in this case it is necessary to draw attention to the fact that the tax involved in this case can, on any footing, only be of a minimal amount. This matter was raised with counsel for the appellant, the Commissioner, at the outset of the hearing. It would appear from the initial response that consideration had not been given to the fact that considerable resources had been involved not only in the preparation of this appeal by those whose primary task it is to collect revenue on behalf of the Government rather than spend it, but in taking up the resources of the court, particularly depriving other litigants of the use of court time taking into consideration the state of the lists.

3. Counsel responded that the case involved matters which were of concern to the Commissioner and involved a general question that the Commissioner wished to have answered. Counsel who appeared in this court, did not appear in court below but it is not impertinent to point out that the first point taken in the court below was that the Board had misapplied the burden of proof specifically as to whether the taxpayer had proved that he had not been subject of dismissal for cause. Given the amount of tax involved it can only be doubted that taking this matter to court on a case stated could hardly be justified on an issue such as that. That is quite beside the fact that the point was a thoroughly bad point in any event. In the second place the taxpayer did not appear in the court below and left the matter entirely to the court. It could not have been supposed that he would have been ready to submit a substantial argument in this court. In this context I should point out that the argument presented in this court on behalf of the Commissioner was, with all due respect, a one-sided argument and hence any authority which a decision might have would be diminished by the fact that there was no adversarial argument either in this court or in the court below.

Background

4. Mott MacDonald Hong Kong Limited ("the employer") employed the taxpayer from 15 May 1997 to 1 March 2004 to work on the West Kowloon Reclamation Project. Over the last year of his employment, Mott MacDonald paid the taxpayer a salary, a housing allowance, and a gratuity of $251,280. Salaries tax was paid on the housing allowance and salary received in 2003-4.

5. The issue before the Board of Review was whether the gratuity, or at least part of it, was subject to tax. The Board found that part of the gratuity, amounting to $103,196, was in the nature of a long service payment under the Employment Ordinance, Cap. 57 ("the Ordinance").

The Board noted that it was the declared policy and established practice of the Revenue that no salaries tax would be assessed or demanded on severance payments and long service payments made in accordance with the Ordinance. For that reason the Board held that the net assessable income of the taxpayer should be reduced by $103,196. The Board said the rest of the gratuity was subject to salaries tax.

6. In relation to what the Board referred to as the declared policy and established practice of the Revenue, the judge said that

> "There is no dispute that the Commissioner's established practice has been that severance and long service payments are not subject to tax."

7. This court was not told what the legal basis for this policy or practice was. Even assuming there is a legal basis for the Government's revenue collecting agency to refrain from collecting revenue that otherwise might be payable, in my view, it is the lack of proper definition of the so termed policy that has caused difficulty in this case.

8. This case has proceeded on the basis that that there was no material distinction between the way severance payments under section 31B and long service payments under section 31R of the Ordinance would be treated. The judge considered that in this case it was the provisions relating to long service payments that were relevant and it is those that will be referred to.

9. The taxpayer had, on the findings of the Board, been employed since 1997. The employment had been on a series of contracts lasting one or two years, the final period being from 1 April 2003 to 31 March 2004. That incorporated the terms of the letter agreement dated 22 February 2002 which was referred to as the Renewal Agreement. Clause 10 of that agreement provided that:

> "On completion of satisfactory service you will receive a gratuity for the period of service on the West Kowloon Reclamation project. The gratuity payable will be the sum which, when added to the Company's contribution to the MPF Scheme, equals to 25% of the total basic salary drawn during your service period on the West Kowloon Reclamation project.
>
> Costs borne by the Company, such as severance pay and long service pay, will be deducted from the gratuity. You will not be entitled to a gratuity in the event of resignation or dismissal for unsatisfactory service."

10. The material provisions of the Ordinance for present purposes are sections 31Y and 31YAA. They read as follows:

> "31Y

> If an employee becomes entitled to payment of a long service payment under this Part and-
>
> (a) because of the operation of the employee's contract of employment, one or more gratuities based on length of service or one or more relevant occupational retirement scheme benefits have been paid to the employee; or
>
> (b) a relevant mandatory provident fund scheme benefit is being held in a mandatory provident fund scheme in respect of the employee, or has been paid to or in respect of the employee,
>
> the long service payment is to be reduced by the total amount of all of the gratuities and benefits to or in respect of the employee to the extent that they relate to the employee's years of service for which the long service payment is payable."
>
> "31YAA
>
> 1) If-
>
> (a) because of the operation of the employee's contract of employment, an employee has become entitled to payment of a gratuity based on length of service, or to payment of a relevant occupational retirement scheme benefit; or
>
> (b) a relevant mandatory provident fund scheme benefit is being held in a mandatory provident fund scheme in respect of the employee,
>
> and the employee has been paid a long service payment under this Part, the gratuity or benefit is, to the extent that it is attributable to the same years of service as those for which the long service payment is payable, to be reduced by the whole of the long service payment."

11. It can thus be seen that the Ordinance prevents an employee from seeking a long service payment if he has already been paid a gratuity which exceeds the statutory long service payment. The second provision provides that an employee's gratuity is to be reduced by any amount that has been paid as a long service payment.

12. It can at once be seen that a strict application of the so termed policy or practice would cause considerable difficulties. An employee who is paid a long service payment which was immediately thereafter supplemented by a gratuity would seemingly not pay tax on the long service payment. So too, an employee who is employed on the basis that the employer contracts to pay the statutory long service payment would be entitled to relief. But, if the terms of the so termed policy

or practice have been understood correctly, an employee who is employed on terms where he would be paid a gratuity which fortuitously happens to be the same as the statutory long service payment would not be entitled to relief.

13. On that basis, irrespective of whether one considers there is any logicality in the situation, what needs to be considered is what payment has been made. That is a question of fact. The facts are for the Board to find. The court will only interfere with a finding of fact by the Board on strict and well defined principles.

14. In this case the Board considered the evidence that was before it including the contracts of employment of the taxpayer and the letter from the employer in answer to questions raised on behalf of the Commissioner. In paragraph 26 of the case stated the Board said:

> "Having considered the Agreement and the Renewal Agreement, the Board found that the Sum paid to the Taxpayer upon completion of the Renewal Agreement consisted of two natures, firstly, a long service payment and secondly, a gratuity equal to 25% of the total basic salary less the MPF contribution and the amount of the long service payment."

15. In paragraph 29 of the case stated it is said:

> "In the Taxpayer's case, the Board found that MMHK made one payment to the Taxpayer. It was held to be a logical inference that the long service payment was made prior to or simultaneously with the payment of the gratuity due to the Taxpayer. Making the gratuity payment before the long service payment would not be possible. Consequently, the Board concluded that if it needed to seek assistance from the EO, the Taxpayer's case showed fall within Section 31YAA instead of Section 31Y of the EO."

16. It was in those circumstances that the Board stated the following questions:

> "(1) On the facts found by the Board, did the Board err in law in holding that the Taxpayer was entitled to payment of a long service payment under the EO?
>
> (2) Did the Board err in law in holding that by operation of clause 10 of the Renewal Agreement, the Board did not need to seek assistance from the provisions of the EO for determination of the Taxpayer's entitlements to a severance payment or a long service payment?
>
> (3) Did the Board err in law in holding that, if assistance would need to be sought from the provisions of the EO, Section 31IA (instead of Section 31I) would have applied in the case of the severance payment, and Section 31YAA

(instead of Section 31Y) would have applied in the case of the long service payment to the Taxpayer?

(4) Did the Board err in law in holding that the Sum of $251,280.00 paid by MMHK consisted of a sum of $103,196.00, being the long service payment to which the Taxpayer was held by the Board to be entitled?"

17. On this appeal no issue was taken in respect of the negative answer in relation to the first question. In relation to the second question the judge considered that as far as the Board was concerned, clause 10 made clear that, notionally if not actually, long service pay must be deemed to have been paid by the employer in advance of or, at the very least, at the same time as the payment of his gratuity.

18. On this appeal Ms Cheng argued that the Board and the court below had failed to take into consideration the payments which had been made on the expiry of previous periods of service namely 14 May 1999 and 31 March 2002. Those payments in themselves amounted to more than $1 million and thus were far in excess of any long service pay entitlement. This was said to be a timing issue which the judge and the Board had overlooked. I can only say that I find it difficult to conceive that both of the Board and the judge would have overlooked the argument. They clearly did not. The Board dealt with it as a finding of fact. Apart from any other passage reference can be made to paragraph 27 of the case stated, cited by the judge at paragraph 63 of the judgment.

19. This, thus, emphasises the point that difficulty arises when an appeal is launched in circumstances where the respondent is not represented and unlikely to put forward an argument with a one-sided argument on behalf of the appellant based on what is said to be a new point or at the very least a point over looked below.

20. Furthermore, as the judge pointed out in paragraph 74 of the judgment, no part of any payment under the earlier periods of employment were ever treated as long service payments, and tax was presumably paid on all sums received.

21. In my view, however, the position should, on principle, be that held by the Board. The Board interpreted clause 10 of the Renewal Agreement and the position of the employer as expressed in answers to questions raised on behalf of the Commissioner as indicating that the employer intended to make the long service payment prior to or at least at the same time as the final gratuity payment. The taxpayer was not entitled to any long service payment until his employment finally ceased on 31 March 2004. The Board said in paragraph 28 of the case stated:

> "In the Taxpayer' s case, the Board held that because the said condition provided that MMHK should bear the costs of a severance payment or the long service payment which should be deducted from the gratuity, those payments could not be reduced by

> the gratuity payable to the Taxpayer. On the other hand, because of the said condition, when a long service payment or severance payment was payable to the Taxpayer, such payment must come before the payment of the gratuity."

22. The agreements prior to the Renewal Agreement had similar provisions to clause 10. In my view, the Board was entitled to hold that whatever payments were made to the taxpayer on completion of the various periods were not to be taken into account in relation to any future entitlement to long service payment. That is a question of freedom of contract; to which the parties were entitled in this context. Here the employer was intending to make payment in respect of long service payment at 31 March 2004, to which the employer regarded the employee as being entitled, in preference to payment of a gratuity.

23. In my view therefore the judge was entitled to answer both the second and third questions in the negative and hence also the fourth. I would only add that any other conclusion would deprive the taxpayer of the concession accorded by the Revenue to all other taxpayers. I would therefore dismiss this appeal.

Hon Lam J:

24. I have the benefit of reading the judgment of Barma J in draft and I agree for the reasons he gave we should allow the appeal. In a nutshell, the Commissioner succeeded on the quantum issue as put by Ms Cheng before this court (see paras.23 to 26 of counsel's written submissions).

25. Apparently, the quantum issue was not clearly raised before the Board. When the case was stated by the Board the Commissioner requested the Board to make additional finding of facts at paragraph 34 though there is a reference to gratuities being paid under earlier agreements at paragraph 15.

26. Nor was the quantum issue clearly identified in the four "questions of law" formulated in the Case. For my part, I have some misgivings whether those four questions properly identified any questions of law. Ms Cheng was unable to dispute the observation that in all likelihood the Commissioner was involved in the formulation of such questions.

27. Whilst the quantum issue had actually been raised before Reyes J (see paras.72 to 76 of his judgment), the learned judge understood that only as an issue raised in the context of Question (3) of the four "questions of law". However, as presented by Ms Cheng, it is relevant to all four questions.

28. My Lord the Vice President referred to similar provisions in the earlier agreements. If the employment of the taxpayer were terminated at the end of each earlier agreements, applying the rationale of the Board on the timing issue (to which the Commissioner did not challenge in this

appeal), each gratuity payment would have consisted of two components: (1) the long service payment that the taxpayer would have been entitled under that employment (if any); and (2) the balance would be gratuity.

29. But the Board did not find any termination of employment at the end of each earlier agreement. Paragraphs 15 and 22 of the Case set out the findings by the Board that the employment of the taxpayer' s employment commenced on 15 May 1997 and ceased on 1 April 2004.

30. Therefore, with respect, when gratuities were paid under the earlier agreements, despite similar wordings to Clause 10 in those agreements, there is no basis to hold that such payments included any element of long service payment.

31. The result is that the earlier gratuity payments are caught by Section 31Y(a) of the Employment Ordinance. The Commissioner can refer to those payments in calculating whether as a matter of quantum any long service payment was payable when the employment ceased on 1 April 2004.

32. Having said that, I share my Lords' views on the question of costs. I understand Ms Cheng quite fairly did not seek to argue that the taxpayer should pay the costs here or below. I agree with the order proposed by Barma J.

Hon Barma J:

33. This was an appeal from a judgment of Reyes J dated 5 November 2007, in which he dismissed an appeal by the Commissioner of Inland Revenue ("the Commissioner") by way of case stated from a decision of the Board of Review ("the Board"). By its decision, the Board had reduced the net assessable income of the taxpayer, Mr Tsai, for the purposes of salaries tax assessment for the year 2003/04 by HK$103,196.

34. The background facts can be briefly stated. The taxpayer, an engineer, was employed by Mott MacDonald Hong Kong Limited ("the employer") between 15 May 1997 and 31 March 2004 to work on the West Kowloon Reclamation Project. His terms of employment during this period were set out in a number of letters of engagement, under each of which he was entitled to be paid salary, a housing allowance, and a gratuity on completion of satisfactory service.

35. On completion of the last year of his employment, the taxpayer was paid, in addition to the salary and housing allowance which he had received, a gratuity of HK$251,280. The taxpayer paid salaries tax on the salary and housing allowance, but contended that the amount paid as a gratuity was not taxable because it was in fact a severance payment and long service payment pursuant to the Employment Ordinance (Cap. 57) ("the EO"), and, as such, was not assessable to tax as it was the policy of the Revenue that salaries tax would not be assessed or demanded on

severance payments and long service payments made in accordance with the EO. The Commissioner disagreed, and concluded that this amount should be included within the amount on which salaries tax was assessable. The taxpayer appealed to the Board against the Commissioner's determination.

36. The issue before the Board was therefore whether the gratuity, or part of it, was subject to tax. There was no dispute as to the existence of the policy on which the taxpayer relied. However, the Revenue contended that no part of the gratuity received by the taxpayer in respect of his final year of employment constituted a long service or severance payment within the terms of the EO.

37. The Board held that HK$103,196 of the gratuity received by the taxpayer was in fact a long service payment, and so was not subject to tax. Reyes J held that the Board had not erred in coming to this conclusion. Throughout, the case has proceeded on the basis that there was no material difference between the way in which severance payments and long service payments in terms of their tax treatment. The Board and the learned judge both considered that the matter should be dealt with on the basis that it was the long service payment provisions of the EO that were engaged, and it is those provisions to which I shall refer below.

38. The relevant provision in the taxpayers' letters of engagement that dealt with his entitlement to be paid a gratuity was Clause 10 in the letter of engagement dated 22 February 2002 (covering the period of employment from 1 April 2002 to 31 March 2003), which was incorporated into the letter of engagement for the final period of his employment (from 1 April 2003 to 31 March 2004). That clause was in the following terms:-

> "On completion of satisfactory service you will receive a gratuity for the period of service on the West Kowloon Reclamation project. The gratuity payable will be the sum which, when added to the Company's contribution to the MPF Scheme, equals to 25% of the total basic salary drawn during your service period on the West Kowloon Reclamation project.
>
> Costs borne by the Company, such as severance pay and long service pay, will be deducted from the gratuity. You will not be entitled to a gratuity in the event of resignation or dismissal for unsatisfactory service."

39. A very similar provision was included in the letters of engagement which governed the earlier period of the taxpayers employment, between 15 May 1997 and 31 March 2002.

40. The taxpayer in fact received a number of payments of gratuity in respect of the periods covered by the earlier letters of engagement under which he was employed, totalling HK$1,447,383, as follows:-

(1) HK$456,308 in respect of his employment between 15 May 1997 and 14 May 1999;

(2) HK$731,673 in respect of his employment between 15 May 1999 and 31 March 2002; and

(3) HK$259,402 in respect of his employment between 1 April 2002 and 31 March 2003.

41. Each of these earlier gratuities was offered for assessment, and salaries tax was paid on them.

42. The material provisions of the EO for present purposes are sections 31Y and 31 YAA. They are in the following terms:-

"31Y. If an employee becomes entitled to payment of a long service payment under this Part and –

(a) because of the operation of the employee's contract of employment, one or more gratuities based on length of service or one or more relevant occupational retirement scheme benefits have been paid to the employee; or

(b) a relevant mandatory provident fund scheme benefit is being held in a mandatory provident fund scheme in respect of the employee, or has been paid to or in respect of the employee,

the long service payment is to be reduced by the total amount of all of the gratuities and benefits to or in respect of the employee to the extent that they relate to the employee's years of service for which the long service payment is payable."

"31YAA. If –

(a) because of the operation of the employee's contract of employment, an employee has become entitled to payment of a gratuity based on length of service, or to payment of a relevant occupational retirement scheme benefit; or

(b) a relevant mandatory provident fund scheme benefit is being held in a mandatory provident fund scheme in respect of the employee,

> and the employee has been paid a long service payment under this Part, the gratuity or benefit is, to the extent that it is attributable to the same years of service as those for which the long service payment is payable, to be reduced by the whole of the long service payment."

43. As Reyes J put it (at paragraph 50 of his judgment), the function of sections 31Y and 31YAA of the EO is to deal with the situation where, having paid (or agreed to pay) a contractual gratuity to an employee, the employer nonetheless finds himself required to make a long service payment. The sections are a safeguard to prevent the employer being required to make a double payment. Thus, if an employee has received, whether through a gratuity or gratuities paid during the course of his service with the employer, or through a relevant occupational retirement scheme benefit, or through payments by the employer into a mandatory provident fund scheme, payments that are related to his length of service, he is not entitled to the statutory long service payment where the payments already made by the employer, would exceed the amount payable as long service pay under the EO (section 31Y). On the other hand, where the employee has been paid an amount by way of long service payment, any gratuity or other benefit to which he would otherwise be entitled will be reduced by the amount of the long service payment received (section 31YAA).

44. In the present case, it was therefore necessary for the Board to determine whether any, and if so what, part of the payment of HK$251,280 paid to the taxpayer at the completion of his employment on 31 March 2004 represented long service pay, which would not be assessable to salaries tax under the policy adopted by the Revenue.

45. As to this, the Board considered the evidence before it and said, at paragraphs 26 to 29 of the Case Stated:-

> "26. Having considered the Agreement [the letter of engagement of 22 May 1997] and the Renewal Agreement [the letter of engagement of 22 February 2002], the Board found that the Sum [i.e., the HK$251,280] paid to the Taxpayer upon completion of the Renewal Agreement consisted of two natures, firstly, a long service payment and secondly, a gratuity equal to 25% of the total basic salary less the MPF contribution and the amount of the long service payment. The Board took this view because of [Clause 10 of the letter of engagement of 22 February 2002].
>
> "27. The Board noted that the above condition was a term agreed between the parties and it was clearly stated therein that costs such as severance pay and long service pay would be deducted from the gratuity. The Board considered that the above provision did not exonerate [the employer] from its obligation to make payment of severance payment and long service payment even when a gratuity was payable and noted that the provision also stipulated that such

payment would be deducted from the gratuity. That being the case, the Board considered that when a severance payment or a long service payment was due to the Taxpayer, [the employer] must pay to the Taxpayer firstly the severance payment or long service payment and then the gratuity. Thus notwithstanding the fact that [the employer] labelled the entirety of the Sum as gratuity, whether inadvertently or otherwise, the Board held that the Sum must consist of, firstly the long service payment to which the Taxpayer was entitled and secondly, the gratuity equal to 25% of the salary drawn, less the MPF contribution and the amount of long service payment due to the Taxpayer. The Board concluded that in law, the nature of the payment could not be altered by the label put to it by [the employer].

"28. The Board noted the Revenue's contention that if a severance payment or long service payment was payable to the Taxpayer, Section 31I or Section 31Y of the EO should apply. However, the Board was of the view that by operation of the said condition, it needed not seek assistance from the EO for determination of the Taxpayer's entitlements. If the Board was wrong on that and it needed to seek assistance from the EO, it took the view that Section 31I or Section 31Y did not apply. The Board observed that Section 31I and Section 31Y respectively provided that if an employee became entitled to payment of a severance payment or a long service payment and because of the operation of the employer's contract, he was also entitled to a gratuity, the severance payment or the long service payment was to be reduced by the gratuity. In the Taxpayer's case, the Board held that because the said condition provided that [the employer] should bear the costs of the severance payment or the long service payment which should be deducted from the gratuity, those payments could not be reduced by the gratuity payable to the Taxpayer. On the other hand, because of the said condition, when a long service payment or a severance payment was payable to the Taxpayer, such payment must come before the payment of the gratuity. The Board considered that taking a different order of payment would not be possible because unless the amount of severance payment or long service payment was calculated and/or paid, the balance of the gratuity due to the Taxpayer could not be ascertained.

"29. In the Taxpayer's case, the Board found that [the employer] made only one payment to the Taxpayer. It was held to be a logical inference that the long service payment was made prior to or simultaneously with the payment of the gratuity due to the Taxpayer. Making the gratuity payment before the long service payment would not be possible. Consequently, the Board concluded that if it needed to seek assistance from the EO, the Taxpayer's case should fall with Section 31YAA instead of Section 31Y of the EO."

46. The Board went on, in paragraph 32 of the Case Stated, to find that the amount of the long service payment due to the taxpayer was HK$103,196, and that the salaries tax assessment against him should therefore be reduced by that amount.

47. Reyes J. held (at paragraphs 60 to 69 of his judgment) that the answer to the question before the Board, namely whether the HK$251,280 was to be regarded as purely a gratuity or partly a gratuity and partly long service pay turned on whether the situation here fell within section 31Y or section 31YAA of the EO – that is, whether a long service payment was made before or at the same time as any gratuity element, or whether the gratuity was payable prior to any long service pay being received by the taxpayer. He agreed with the Board that having regard to the terms of Clause 10, the former was the case, so that section 31YAA applied.

48. Before us, Ms Cheng (who did not appear below), for the Commissioner, did not seek to challenge this conclusion. She submitted, however, that even so, it was necessary to go one step further, and ask whether any amount in respect of long service pay was in fact payable to the taxpayer when he ceased to be employed by the employer on 31 March 2004. Ms Cheng submitted that, contrary to the conclusions of the Board and Reyes J that long service pay in the amount of HK$103,196 was payable to the taxpayer, no long service pay was in fact payable having regard to the provisions of section 31Y, given that the taxpayer had previously received well over this amount in the form of the earlier gratuities paid to him.

49. Ms Cheng submitted that the earlier gratuities had to be taken into account, having regard to the terms of section 31Y. Although the taxpayer would in principle have been entitled to receive a long service payment on the termination of his employment, having been employed under a continuous contract of employment for over five years, it remained necessary to ascertain what, if anything, the amount of that payment should have been.

50. Ms Cheng submitted that the earlier gratuities that had been paid to the taxpayer were clearly "gratuities based on length of service", and as such came within subparagraph (a) of section 31Y of the EO. This would seem to be right – each of the gratuities was payable on completion of satisfactory service. In Clause 10, the gratuity payable was expressly stated to be "for the period of service". The amount of the gratuity was to be calculated by reference to the total basic salary drawn by the taxpayer over the period in question – a figure that necessarily had to be based on the length of his service with the employer.

51. That being so, it seems to me that Ms Cheng is right to submit that any amount of long service pay that would, in principle, have been payable by the employer to the taxpayer on the termination of the taxpayer's employment would fall to be reduced by the amount of the gratuities previously received. Here, the amount of the gratuities which had already been paid by 31 March 2003 greatly exceeded the amount of long service pay to which the Taxpayer would have been entitled. The effect of section 31Y of the EO was, therefore, that on the termination of his

employment on 31 March 2004, the taxpayer was not entitled to receive any amount of long service pay from the employer. It is clear that section 31Y of the EO is intended to relate to all gratuities received which are referable to the period in respect of which a long service payment would be payable – this appears from the reference to "one or more gratuities" in subparagraph (a), which is, I think, a clear reference to the situation, as here, where gratuities have been paid from time during the course of the employee's employment with the same employer.

52. This point does not appear to have been considered by the Board of Review in reaching the conclusion to which it came. It appears to have proceeded on the basis that the key issue was whether the terms of Clause 10 meant that any long service pay was to be paid prior to any element of gratuity, or vice versa. It does not seem to have been appreciated (perhaps because of the way the argument on behalf of the Commissioner was put before it) that even if the former were the case, section 31Y remained relevant for the purpose of determining the amount of any long service payment that might be payable.

53. This emerges clearly from paragraph 28 of the Case Stated, in which the Board took the view that having answered the question of construction in the taxpayer's favour, section 31Y ceased to be relevant. It also appears that the Board focussed on the final year's gratuity, and did not regard any of the previous gratuities as being of relevance. In this, I am afraid that they were in error.

54. The previous gratuities were raised in the argument for the Commissioner before Reyes J. However, as Lam J has pointed out, it appears at that stage to have been suggested that they were relevant only to the third question of law in the Case Stated, whereas on the argument as advanced by Ms Cheng before us, they were in fact relevant to all four of the questions of law posed. Perhaps because of this, Reyes J considered that the receipt of the earlier gratuities by the taxpayer was not relevant to the Board's analysis of the position (see paragraphs 70 to 77 of his judgment). However, for the reasons which I have explained in paragraphs 16 to 19 above, the receipt by the taxpayer of the earlier gratuities resulted in section 31Y being engaged, so as to reduce to nil the amount of long service payment that would have been payable to the taxpayer on the termination of his employment. I am therefore, with respect, unable to agree that these earlier payments were irrelevant. Nor do I see that there would be any element of double taxation arising from the fact that salaries tax had been paid on the earlier gratuities – any tax payable on the final gratuity would relate to that gratuity and not the earlier ones.

55. In these circumstances, it seems to me that the Board were wrong to find as a fact that HK$103,196 out of the sum of HK$251,280 represented a long service payment to the taxpayer, which was not assessable to tax pursuant to the policy adopted by the Revenue in relation to the taxability of long service and severance payments. Further, as this mistaken finding was due to a failure by the Board to correctly apply the provisions of section 31Y of the EO, there has been, in my view, an error of law by the Board, which requires its finding to be set aside.

56. For all of these reasons, it seems to me that each of the questions in the Case Stated should be answered in the affirmative, and this appeal allowed.

57. I would, however, wish to make the following additional observations:-

(1) The amount of tax involved in this appeal was minimal, amounting to at best a little over HK$15,000. I have little doubt that the costs involved on the Commissioner's side in mounting this appeal (both to the court below and in this court) would have far exceeded this amount. No doubt because of this, the taxpayer decided to take no part in the hearing before Reyes J, and although he appeared before us, made no submissions of substance, asking only that the matter should be finally resolved one way or the other. When pressed as to this, Ms Cheng (having taken instructions during the course of the hearing before us) indicated that although this was so, the Commissioner felt that it was desirable to have this question clarified as there were a large number of similar cases in which the same question arose. In these circumstances, I would not be inclined to make any award of costs in favour of the Commissioner, notwithstanding that I would allow his appeal.

(2) The precise legal basis for the Commissioner's policy of not subjecting long service and severance payments to tax was never made clear. Be this as it may, it is not difficult to see that taxpayers may well perceive a certain lack of logic in the way in which this policy operates in practice, in that depending on the terms on which they are employed, some taxpayers will receive long service payments which are not taxable as a result of the policy, while others will not be entitled to such payments, and will have to pay tax on the payments received by them which (so far as the EO is concerned) stand as substitutes for such payments.

58. I would therefore allow this appeal, but so far as costs are concerned, would make an order that there should be no order as to costs as between the Commissioner and the taxpayer, either here or below. As I understood it, Ms Cheng did not oppose such an order, which I think would be the appropriate one given that the argument before us seems to have proceeded on a somewhat different basis from that below, and also having regard to the fact that the amounts at stake were very small.

Hon Rogers VP:

59. This appeal will be allowed by a majority. In answer to a question from the court counsel for the appellant indicated that an order for costs would not be sought no matter what the outcome of the appeal would be. There will be no order as to costs.

(Anthony Rogers)	(M H Lam)	(Aarif Barma)
Vice-President	Judge of the Court of First Instance	Judge of the Court of First Instance

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

The Respondent in person