HCIA 4/2019
[2021] HKCFI 1846

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
INLAND REVENUE APPEAL NO. 4 OF 2019

BETWEEN

HEATH BRIAN ZARIN Appellant

and

THE COMMISSIONER OF INLAND REVENUE Respondent

Before: Hon Coleman J in Chambers (Open to Public)
Date of Submissions: 26 June, 10 and 17 July 2020
Date of Judgment: 29 June 2021

J U D G M E N T

A. Introduction

1. This is an appeal by the appellant ("Taxpayer") from the decision D11/19 ("Decision") of the Inland Revenue Board of Review ("Board") dated 23 August 2019. The Decision dismissed the appellant's appeal against a Determination by the respondent Commissioner of Inland Revenue ("CIR") confirming certain additional assessments to salaries tax ("Assessments"), raised by the CIR under sections 8 and 9 of the Inland Revenue Ordinance Cap 112 ("IRO").

2. The appeal was originally sought to be pursued in relation to various constituent elements of the Assessments, which have been defined earlier as "Sum A", "Sum B1", "Sum B2", "Sum C" and "Sum D". By my decision dated 19 December 2019 [2019] HKCFI 3101 ("Leave Decision"), I refused leave to appeal in respect of Sums A, B1, B2, and C, but granted leave to appeal in respect of Sum D.

3. I decided the substantive appeal in respect of Sum D on paper submissions, in a judgment dated 11 March 2020 [2020] HKCFI 330, now reported at [2020] 2 HKLRD 229 ("Sum D Decision"). I allowed the appeal.

4. Also on 11 March 2020, Yuen JA gave Judgment [2020] HKCA 147 on the Taxpayer's renewed application for leave to appeal as regards Sums B2 and C only (no further challenge being made as regards Sums A and B1). Yuen JA granted leave to appeal on the ground underpinning Sums B2 and C – which was articulated to her in a slightly different way than it had been put to me – and the matter was remitted to me to deal with the substantive appeal.

5. Therefore, I am in the slightly odd position of having to determine the merits of an appeal on a ground which I previously thought was not reasonably arguable. For that reason, I have delayed in considering the appeal so as to allow a 'fresh' approach.

6. I gave directions for the appeal to be dealt with on paper submissions. As throughout, Mr Stefano Mariani, of Deacons, acted for the Taxpayer, and Mr Wilson Leung, of Counsel, instructed by the Department of Justice, acted for the CIR.

B. Background Facts

7. The full background facts can be found set out in the Leave Decision. For present purposes, it suffices to identify the following.

8. The Taxpayer was employed by a bank ("Company"), under a countersigned employment letter ("Employment Contract"). Under the Employment Contract, amongst other things, the Taxpayer was provided with participation in a "discretionary bonus scheme", under which the Company may in its discretion award a bonus which might take the form of cash, or shares, or a combination of both. As is typical with shares awarded under such a scheme, the vesting of shares would take place over a number of years.

9. Relevantly, as part of his discretionary bonus for the performance year 2011, on 12 March 2012 the Taxpayer was granted a restricted share award of shares, defined in the Decision as the "2012 Shares". Those shares were to vest as to 33%, 33% and 34% in March 2013, 2014 and 2015 respectively.

10. Amongst the terms of the share plan ("Plan") were terms that: (a) participation in the Plan was governed by the rules of the Plan and did not form part of the Employment Contract; (b) the award would vest on the vesting date specified, provided the participant remained continuously employed within the Group or fell within the scope of the 'good leaver' provisions set out in the Plan; (c) awards might be amended, reduced or cancelled by a relevant remuneration committee at any time before the award vested, and the committee had the discretion to impose additional conditions on the awards; (d) if the participant left the Group before the vesting date(s) as a good leaver, then subject to the approval of the committee and the policy of the Company, the awards would vest in full on the vesting date(s) subject to the committee's authority already mentioned; (e) good leaver reasons included, amongst other things, redundancy; and (f) where the rule of good leaver is applied and the participant had entered into a termination agreement in connection with the cessation of employment, the awards would

not vest until the participant had complied with, or was released from his obligations under, that termination agreement.

11. By letter dated 21 January 2013, the Company terminated the Taxpayer's employment on the grounds of redundancy. Amongst other things, the letter stated its terms would be in full and final settlement of the termination of employment, and that the Taxpayer would be treated as a good leaver, and the vesting of any un-vested shares would be conditional on his compliance with the terms in the letter, one term being that the Taxpayer would assist the Company and any group company in relation to certain litigation ("Litigation") regarding the Company's investment in a particular company, including attendance at court or arbitration hearings outside Hong Kong.

12. The Taxpayer did not accept those terms offered, and he made alternate suggestions. There then followed negotiations between solicitors appointed on behalf of the Company and the Taxpayer. Ultimately, by letter dated 20 June 2013 from the Company's solicitors, signed by the Taxpayer on 21 June 2013, revised terms and conditions regarding the taxpayer's termination of employment were agreed ("Termination Agreement").

13. The terms of the Termination Agreement included:

(1) because the Taxpayer's employment was terminated by reason of redundancy, he would be treated as a good leaver so that all remaining restricted shares previously awarded to the Taxpayer would vest on the same terms as stated in the letters awarding them to the Taxpayer;

(2) any release of the 2012 Shares would be conditional on the Taxpayer having not committed a breach of any of the terms of the Termination Agreement, including providing reasonable assistance, as set out in the Termination Agreement, in respect of the Litigation;

(3) if the Taxpayer committed a breach of any of the terms of the Termination Agreement, any unvested 2012 Shares would be forfeited and the Taxpayer would repay the cash value of any shares vested in the period from termination of employment and the date of breach;

(4) the Taxpayer would be obliged to provide reasonable assistance in proceedings and any matter with which he was dealing during his employment in relation to which he had relevant knowledge, as well as specifically the Litigation;

(5) the Taxpayer agreed to withdraw an outstanding data access request and not to issue any similar one;

(6) except for a claim to enforce the Termination Agreement itself, the Taxpayer agreed to release and discharge the Company and related parties from all claims etc in connection with the employment or the cessation of the employment, including any claims for carried interest, bonus, restricted shares under the plan and any payments during employment or arising from cessation of employment.

14. The Company subsequently filed notifications by an employer in which it reported the Taxpayer as being in receipt of released restricted shares, as against the date of the award, date of release, number of shares released and market price, hence reportable value. The reported value included, amongst others:

(1) the sum of $1,764,805 ("Sum B2") released on 12 March 2014 as part of the 2012 Shares; and

(2) the sum of $1,579,820 ("Sum C") released on 12 March 2015 as part of the 2012 Shares.

15. The Assessor raised the additional Assessments to salaries tax on (amongst others) Sums B2 and C. The Taxpayer objected to the additional Assessments, but the Assessments were upheld in the Deputy Commissioner of Inland Revenue's Determination dated 29 November 2017. The Taxpayer appealed to the Board against the Determination. The Board dismissed that appeal by its Decision.

C. The Decision

16. A fuller description of the Decision can be found in the Leave Decision. For present purposes, the following suffices.

17. The Board found the Taxpayer's evidence to be credible, and considered his testimony as part of the body of evidence as a whole.

18. As to Sum B2 and Sum C, the Board noted that they were derived from the 2012 Shares, as part of a discretionary bonus which provided no guarantee of them or their value. Having referred to clause 1.1(b) of the Termination Agreement, the Board found Sum B2 and Sum C to represent the value of shares the Company released to the Taxpayer pursuant to the Termination Agreement, instead of being contractual entitlements under the Employment Contract.

19. Nevertheless, the Board noted that was not determinative as to whether their value was "income from employment", and went on to consider the purpose for which the employer made the payment to the employee. To ascertain that purpose, the Board considered the background against which the Termination Agreement was entered into, engaging in what might be described as a "multi-factorial assessment". The Board looked in particular at the background circumstances, the correspondence between solicitors for the Taxpayer and the Company, what it regarded as the peripheral importance

of the data access request, and the general confidentiality provision and withdrawal of threat of litigation in the Termination Agreement as not constituting a fresh bargain. The Board held overall that the disagreement between the Taxpayer and the Company had not gone to the point that litigation was imminent or where the Company was eager to settle to avoid litigation.

20. On that basis, the Board distinguished the facts from those in the *Poon* case (see below), which involved the making of a payment as "consideration to make the Taxpayer go away quietly". The Board held that the continuing release of the 2012 Shares to the Taxpayer was "in return for acting or being an employee" or as a "reward for past services" and was not "for something else". Hence, the Board considered, Sum B2 and Sum C were "income from employment" chargeable to salaries tax.

D. Applicable Principles

21. There is no real dispute as to applicable principles, nor that they were properly set out in the Decision.

22. Section 8(1)(a) of the IRO materially 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 – (a) any office or employment of profit;"

23. Section 9(1)(a) of the IRA materially provides as follows:

> "(1) Income from any office or employment includes – (a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others [with certain exceptions not applicable in this case]"

24. In *Fuchs v CIR* (2011) 14 HKCFAR 74, the Court of Final Appeal summarised the correct approach, in particular at §§14-22. That was a case which, on its facts, involved a taxpayer who had an accrued right under his contract of employment to be paid certain sums upon termination. Applying the principles, there was little difficulty in holding that the payments received by him were sourced in his employment and so chargeable to salaries tax. But it was also specifically recognised, at §13, that it is often difficult to decide whether the facts of a particular case fall within the statutory language.

25. Indeed, it is not always easy to reconcile the various previous authorities, some of which were summarised by Chung J in *Murad v Commissioner of Inland Revenue* [2009] 6 HKC 478 at §§20-22. But that may be no surprise when particular cases may be "difficult, borderline and depending on narrow distinctions": see *Comptroller-General of Inland Revenue v Knight* [1973] AC 428, at 433.

26. A broad summary of the principles relevant to the present appeal is as follows:

(1) Section 9(1)(a) makes clear that bonuses, including the vesting of restricted shares by virtue of an employment related security scheme, fall within "income" from employment for the purposes of the section 8(1) charging provision.

(2) But the question regarding the chargeability to tax of any particular bonus involves the construction of section 8(1)(a) of the IRO, namely whether that payment is income "from" any office or employment of profit.

(3) Not every payment which an employee receives from his employer is necessarily income "from his employment". It is not sufficient to qualify a payment in that way simply because the employee would not have received the sum in question if he had not been an employee.

(4) Income chargeable under section 8(1) is not confined to income earned in the course of employment, but embraces payments made "in return for acting as or being an employee", or "as a reward for past services or as an inducement to enter into employment and provide future services".

(5) If a payment, viewed as a matter of substance and not merely of form and without being "blinded by some formulae which the parties may have used", is found to be derived from the taxpayer's employment in the sense mentioned above, it is assessable.

(6) The vital question is what is the "substance of the bargain" made between the employer and the taxpayer for the payments in question. Thus, even a gratuity would still be chargeable if payment is a reward from the employer (for example for past services), even though the employer was not obliged to pay it and thus the employee has no legal entitlement to it.

(7) A payment that is concluded as being "for something else" is not assessable, and does not come within the above test.

(8) Insofar as it is contended that a payment was not made in return for a taxpayer acting as or being an employee, but as consideration for "abrogating" his rights under the contract of employment, the operative test must always be the test identified above, reflecting the statutory language. The question is always: 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 does not matter 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".

(9) The "abrogation" examples may reach the conclusion that a payment is made in consideration of an employee agreeing to surrender or forego his pre-existing contractual rights, but "abrogation of contractual rights" is not itself the test of chargeability in every termination situation. The test is not whether the employer had acted in breach in terminating the contract. In every case, the test remains that of the purpose of the payment at the relevant time.

(10) Hence, in the context of payments made upon termination of employment, the same consideration applies: What was the substance of the bargain for the payments in question? What was the purpose of the payment? Was it a reward for services past, present or future (in which case it was from his employment or office), or was it "for some other reason" (in which case it was not)?

(11) If the employee was entitled to the payment under the contract of employment, then the purpose of the payment was in order for the employer to perform its obligations under the contract, and it follows that the payment was income "from" the employment. But if the employee was not so entitled, then one must go on to consider the purpose for which the employer made that payment.

27. In *CIR v Poon Cho-ming John* [2019] HKCFA 38, the CFA confirmed that the applicable principles are those set out in *Fuchs*, and that the Court of Appeal had correctly applied those principles on the particular facts of the *Poon* case.

28. As I put it in the Sum D Decision at §25, ultimately each case involves applying the statutory language to the facts. Despite the different phrases used by judges in other cases to describe where the source of payment satisfies the statutory language that it is "from" employment, those cases only provide guidance and it remains the statutory words which are to be applied.

29. It is necessary to look at the substance, not the form or formulae or labels which might have been adopted by the parties. Entitlement to a payment under a

contract of employment would indicate the payment is from employment, but even the absence of such an entitlement then requires looking further at the purpose of the payment. At bottom, the question remains whether the income is "from" the taxpayer's "employment".

30. Another relevant principle potentially applicable in this context is that, before the Board, the Taxpayer bore the burden of proof throughout, and the CIR did not have the burden of proving anything. For that reason, an appeal before the Board may be disposed of simply on the basis of burden of proof where a taxpayer fails for having failed to discharge that burden.

E. The Appeal

31. When argued before me on the original leave application, the main point made was as regards what was said to be the manifest inconsistency between the finding of fact that Sums B2 and C represented the value of shares released pursuant to the Termination Agreement and the conclusion nevertheless that those sums were from the Taxpayer's employment for the purposes of the charge to salaries tax. It was said that there is a logical fallacy in confusing correlation with causation.

32. As was recognised by Yuen JA, since then the point has been slightly differently articulated. My summary of Mr Mariani's argument on this appeal is as follows:

(1) The 2012 Shares were granted to the Taxpayer while he was employed by the Company.

(2) But the 2012 Shares did not vest at the same time.

(3) Under the relevant rules of the share award plan, the grant of shares did not entitle the employee to a transfer of those shares, so that the grantee received nothing of value unless and until the shares vested in accordance with the rules.

(4) In other words, the mere grant of shares was not a "payment", and any "payment" potentially chargeable to salaries tax took place only upon vesting.

(5) The rules emphasised the relevant employer's apparently unfettered discretion to impose vesting conditions as it saw fit, which might relate to performance in employment, but which could in principle be unrelated to performance in employment.

(6) Further, the rules provided that the unvested shares of a "good leaver" would vest subject to any performance-related or other conditions imposed by the employer or the Group. In that regard, the Company or Group had an unfettered discretion to

impose such other conditions, including non-performance related conditions, as they saw fit to progress the vesting of any tranche of shares unvested as at the date of the termination of the leaver's employment.

(7) Rule 5.7 of the Plan rules stipulated that where the employee entered into a termination agreement in connection with the cessation of his employment, and subject to the discretion of the Group unilaterally to cancel a grant of shares or otherwise to impose such further conditions as it saw fit, the award in question would not vest until the outgoing employee had complied with the terms of that termination agreement.

(8) The rules of the Plan also made clear that the rules and operation of the Plan did not form part of the Contract of Employment, and that rights and obligations arising from the employment relationship were separate. Further, no employee had a right to compensation for any loss in relation to the Plan, including loss or reduction of rights or expectations in circumstances of the termination of employment.

(9) Therefore, the net effect of the rules was that the Group and the Company of any outgoing employee dismissed by reason of redundancy had an unfettered discretion as to whether that employee in fact received any part of any unvested tranche of shares.

(10) The Termination Agreement was a discrete contract between the Taxpayer and the Company.

(11) Under the Termination Agreement, the continued vesting of the 2012 Shares was expressly stated to be in consideration for the Taxpayer agreeing to the terms of the Termination Agreement.

(12) Further, in consideration for the Company's agreement to matters in clause 1 of the Termination Agreement, the Taxpayer covenanted and gave undertakings as to various matters, including assisting in the Litigation, as well as withdrawing a data access request previously lodged and agreeing not to assert any rights to any carried interest.

(13) Those covenants and undertakings were fresh consideration provided by the Taxpayer in order to procure the Company to agree to matters including the vesting of the 2012 Shares.

(14) The Taxpayer had not been entitled, either contractually or beneficially, to Sum B2 and Sum C as at the date of the

termination of his employment, and it was the due compliance with the terms of the Termination Agreement which led to the vesting of the 2012 Shares.

(15) Only when the 2012 Shares actually vested was anything received of value, and the things the Taxpayer did or agreed not to do to secure that vesting related to matters following the termination of his employment and during a period when he was not employed.

(16) Whilst the grant of the 2012 Shares was a function of the taxpayer's performance as an employee, the proximate cause of the vesting of the 2012 Shares is a separate matter.

(17) The position is binary; either a sum is "from" employment, or it is not. If the relevant question is posed as to whether the vesting of the 2012 Shares was reward for the Taxpayer's past, present, or future services in employment, or otherwise for acting as an employee of the Company, the answer must be 'No'.

(18) This is because the vesting of the 2012 Shares was consideration for the contractual obligations agreed under the Termination Agreement, which was made six months after the Taxpayer's employment had ended.

33. Mr Mariani also submitted that the Board misunderstood the case advanced by the Taxpayer before it. He had not suggested that Sum B2 and Sum C were paid to him so that he would "go quietly" in the sense that, as in the *Poon* case, the threatened actions of the Taxpayer would have incurred reputational and administrative prejudice to the Company or Group. The fundamental issue was simply for what reason the 2012 Shares were released. In that regard, the Board did find that the 2012 Shares were in reality released pursuant to the Termination Agreement, which it is common ground was not a contract of employment. Therefore, any suggestion that the Taxpayer could have secured the vesting of the 2012 Shares had he remained in employment and met conditions for vesting to which he was subject *qua* employee is simply a counterfactual suggestion, not entailing that Sum B2 or Sum C in fact arose from his employment.

34. Further, Mr Mariani submitted that the fact that the 2012 Shares were initially granted as a function of performance in employment goes only to quantum and is not causally relevant – which is the proper question under section 8(1). Looking at that question, Mr Mariani submitted that the bargain struck under the Termination agreement was in essence: "you, the Taxpayer, are no longer employed by us, the Company, but if you now do for us these things that you are not and were never before obliged to do, we shall in return transfer to you the shares to which you are not entitled, and which we are not otherwise obliged to transfer to you".

35. In his submissions for the CIR, Mr Leung emphasised that the Taxpayer has a heavy burden to discharge on this appeal, where the Board has made an unequivocal finding that Sums B2 and C were "from" the Taxpayer's "employment", which is a question of fact or alternatively mixed fact and law. Hence, the Taxpayer must show that the Board's conclusion was contrary to the true and only reasonable conclusion, but he cannot show that. My summary of Mr Leung's argument is as follows:

(1) Sums B2 and C represented part of the value of the 2012 Shares.

(2) The 2012 Shares were granted to the Taxpayer in recognition of his job performance, and as an important component of his employment compensation package.

(3) Whilst it is correct that the Board found that the 2012 Shares were released to the Taxpayer (allowed to vest) pursuant to the Termination Agreement – as opposed to being contractual entitlements under the Employment Contract – the Board also correctly found that was not determinative of the relevant question.

(4) Numerous cases identify payments made pursuant to a termination (or similar) agreement which are nevertheless held to be "from" employment.

(5) Even a payment of a sum to which the employee has no contractual entitlement may still be taxable if it satisfies the statutory test.

(6) Hence, the Board's task remained to consider the purpose for which the Company made the payments to the Taxpayer in the form of the vesting of the 2012 Shares, to answer the statutory question whether it was "from" the employment.

(7) The Board fully considered the factual matrix, and the submissions made to it on behalf of the Taxpayer that Sums B2 and C were only released to him due to additional obligations undertaken by him under the Termination Agreement.

(8) The Board found as facts that: (a) the disagreement between the Taxpayer and the Company had not reached the stage where litigation was imminent, so the 2012 Shares were not released for the purpose of settling potential litigation; (b) the taxpayer's agreement to withdraw his data access request was a matter of tactical and peripheral importance; and (c) the confidentiality provision did not constitute a fresh bargain for which Sums B2 and C were paid.

(9) The Board was also alive to the distinction between the grant and vesting of shares, but held that the vesting was nevertheless "in return for acting or being an employee" or as a "reward for past services".

(10) Arguments about the effect of the rules under the share award plan, intended to identify the Taxpayer having had no contractual entitlement to the vesting of the 2012 Shares, are a 'red herring'.

(11) Anyway, as explained by the Taxpayer in his own witness statement, a good leaver would have at least an expectation (albeit no strict contractual entitlement) that the Company would allow shares to continue to vest, as that is the very point of good leaver status.

(12) The consideration provided for the Taxpayer's assistance with the Litigation was the Sum D payment (as held in the Sum D Decision, consistent with the underlying documents), and it is not correct now to argue that Sums B2 and C were paid for that assistance.

36. As regards the question whether the ground of appeal is a question of fact or law, I agree with Mr Mariani that Yuen JA's grant of leave to appeal must have been on the basis that the ground of appeal is on a point of law. Indeed, she footnoted that, in the Leave Decision, I did not hold that no question of law arose on this ground. I also agree that the proper construction of the statute, the Employment Contract and share award rules and the Termination Agreement are matters of law. So I agree that I might set aside any part of the Decision which I think is tainted by an error of law committed by the Board.

37. Of course, Mr Leung is correct in saying that a finding of fact may be challenged as an error of law in certain, limited, circumstances, being: (a) if the decision was based on a finding of fact or inference from the facts which was perverse or irrational; (b) if there was no evidence to support the decision; (c) if the decision was made by reference to irrelevant factors; or (d) if the decision was made without regard to relevant factors: see *Kwong Mile Services Ltd v CIR* (2004) 7 HKCFAR 275 at §§31-34.

38. However, in the event, I do not think it is necessary to be tied up by this discussion. The appeal turns on whether the Board made an error of law in deciding that the particular facts of this case triggered chargeability to tax on the proper interpretation of section 8(1).

39. In his further reply submissions, Mr Mariani emphasised that this is a case where the Taxpayer had no vested right upon the termination of his employment, and only acquired the right to be paid Sums B2 and C upon agreeing to enter into the Termination Agreement. By that time, the Employment Contract had gone altogether, the employment period having ended some six months earlier. Mr Mariani submitted that it

is not sufficient that there is merely some broad nexus or connection between the Taxpayer's employment and the payment of Sums B2 and C for those sums to be "from" employment for the purposes of section 8(1), and the Court should be astute not to apply some sort of 'but for' test along the lines that but for the fact that the Taxpayer had been employed by the Company he would never have received Sums B2 and C. What is required is to focus on the purpose of the payment, identifying the causal element. Only if the purpose of vesting the 2012 Shares was to reward the Taxpayer for past service in employment with the Company would Sums B2 and C be properly chargeable to salaries tax.

40. Here, submitted Mr Mariani, the vesting of the 2012 Shares was to procure the Taxpayer to enter into the Termination Agreement and to make the covenants and give the undertakings therein. Further, whilst Sum D was to compensate the Taxpayer for the time actually incurred in assisting with the Litigation (for example by his attendance in Singapore), he was persuaded to provide the assistance at all – and possibly for as long as five years – by the Company's commitment, amongst other things, to progress the vesting of the 2012 Shares. Therefore, Sum D was only part of the consideration moving from the Company to procure the covenants and undertakings given by the Taxpayer under the Termination Agreement.

41. In light of the Leave Decision, but the grant of leave on the renewed application made to the Court of Appeal, I have of course considered what appeared to influence that grant of leave. In her Judgment granting leave to appeal, Yuen JA placed weight upon the following matters:

(1) The Board apparently failed to consider the Taxpayer's submissions that his undertaking to assist in the Litigation was "good consideration" for a "fresh bargain" between himself and the Company. But the Company's requirement that the Taxpayer provide positive, specific active assistance for up to 5 years featured prominently in the Termination Agreement.

(2) So it can reasonably be argued that the Taxpayer's undertaking to perform future acts of assistance to the Company in the Litigation, pursuant to the Termination Agreement, was extraneous to previous service as an employee, and in a different capacity, and that the obligation to perform those acts was the *quid pro quo* for the release of the Sum B2 and Sum C shares in the Termination Agreement.

(3) The Company's stand appeared to be that the shares would not be vested if the Taxpayer refused to perform the future acts of assistance, and the Termination Agreement specified that any release of the 2012 Shares would be conditional on his having not committed a breach of any of the terms of it. Any breach would lead to the forfeit of any unvested 2012 Shares.

(4) So it can reasonably be argued that whilst the number of shares awarded may have been considered with reference to his performance in the past, the vesting of the shares was in substance the result of the bargain contained in the Termination Agreement, in which the undertaking to assist in the Litigation featured prominently.

42. Though the grant of leave was simply by reference to the reasonable arguability on those points, those points have been argued in the appeal (amongst others) as sufficiently strong to warrant allowing the appeal.

43. I bear in mind that the Board itself said the mere fact that the release of the 2012 Shares was made pursuant to the Termination Agreement is not determinative as to whether their value paid to the Taxpayer was income from employment. It remained necessary to consider the purpose for which the Company made that payment, there being many cases (and *Fuchs* was one of them) where sums paid pursuant to a termination or similar agreement have nevertheless been held to be "from" employment. I also note that the Board examined the facts to ascertain the purpose of the payment, of course including the terms of the Termination Agreement itself and the factual matrix against which it was made.

44. The Board made a finding of fact that the 2012 Shares were not released for the purpose of settling potential litigation, because it did not accept that there was in fact sufficient prospect of litigation. On the other hand, that finding does not simply lead to the conclusion that the purpose of continuing release of the 2012 Shares was "in return for acting or being an employee" or as a "reward for past services" – if there might be another purpose.

45. In the Leave Decision I noted that the supposed conditionality for release of the 2012 Shares, against compliance with the terms of the Termination Agreement, was something in any event foreshadowed by the terms of the relevant Plan. I have also touched on those terms when dealing with background matters above. Those terms provided that the award would vest on the vesting date specified, provided the participant remained continuously employed within the Group or fell within the scope of the good leaver provisions set out in the Plans. But the Plan also specified that where the rule of good leaver is applied and the participant had entered into a termination agreement in connection with the cessation of employment, the awards would not vest until the participant had complied with, or was released from his obligations under, that termination agreement. The Plan specifically envisaged that if, as became the fact, the Taxpayer left as a good leaver his awards would vest so long as, albeit not until, he complied with any termination agreement entered into.

46. Upon further reflection, and in light of the arguments on the appeal, those provisions seem to me to be important, but not for the reasons I previously had in mind. At the time that any employee became a participant in and subject to the Plan, it obviously would not be known under what circumstances the employee might cease employment. Nor would it be known, even if the participant were to be a good leaver,

whether the participant might enter into a termination agreement with regard to the cessation of employment, and if so what those terms might encompass. Yet the Plan identified that the awards would not vest unless and until the participant had complied with, or been released from, whatever obligations might be contained in any particular termination agreement. So the Plan envisaged that a participant/employee might have to provide perhaps fresh consideration to become entitled to vesting, and such fresh consideration might have nothing to do with the employment.

47. I think this is very much a borderline case. Ultimately, I am persuaded that the terms of this particular Termination Agreement identify that the purpose for releasing the 2012 Shares was, amongst other things, to procure the Taxpayer to provide potentially long-term assistance in the Litigation (where another, but separate, part of the consideration – Sum D – was to compensate the Taxpayer for time actually spent and expenses incurred when providing that assistance). On that basis, Sum B2 and Sum C was not "from" the Taxpayer's "employment". It was "from something else".

F. Conclusion

48. Therefore, I allow the appeal.

49. Though I have not heard argument on costs, it seems to me that the appropriate course is to make an order *nisi* that the costs shall follow the event of the appeal, namely that the Taxpayer's costs of the appeal (encompassing any such costs as were ordered to be in the cause of the appeal) shall be payable by the CIR, to be taxed if not agreed.

50. The costs order *nisi* will become absolute if no variation application is made within 14 days. Any variation application will be dealt with on paper submissions.

(Russell Coleman)
Judge of the Court of First Instance
High Court

Mr Stefano Mariani, instructed by Deacons, for the appellant

Mr Wilson Leung, instructed by Department of Justice, for the respondent