

**IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
INLAND REVENUE APPEAL NO 5 OF 2020**

BETWEEN

MARK ANDREW WILSON

Applicant

and

COMMISSIONER OF INLAND REVENUE

Respondent

Before: Hon Anthony Chan J in Court
Date of Hearing: 9 June 2021
Date of Judgment: 15 July 2021

JUDGMENT

1. This is the Applicant Taxpayer’s application for leave to appeal a Decision (D8/20) of the Inland Revenue Board of Review (“Board”) dated 21 September 2020 (“Decision”) by which the Taxpayer’s appeal against a Determination of the Deputy Commissioner of Inland Revenue dated 28 May 2019 was dismissed.

Issue

2. The Determination concerned whether Salaries Tax was chargeable on 3 sums of money paid to the Taxpayer by his former employer.

Legal framework

3. Pursuant to s.69(3)(e) of the Inland Revenue Ordinance, Cap 112 (“Ordinance”), leave to appeal must not be granted unless the Court of First Instance is satisfied :

- (i) that a question of law is involved in the proposed appeal; and
- (ii) that –

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- (A) the proposed appeal has a reasonable prospect of success;
or
- (B) there is some other reason in the interests of justice why the proposed appeal should be heard.

4. The Taxpayer relies on both (A) and (B) stated above.

5. In the Taxpayer's Statement ("Statement") in support of his application for leave to appeal (filed pursuant to s.69(3)(a)(ii) of the Ordinance), he must identify and state a proper question of law for determination by the court. It must precisely identify the point of law involved or any specific legal error or question: see *China Mobile Hong Kong Co Ltd v Commissioner of Inland Revenue* [2018] 2 HKLRD 146, §§27, 30(4) per Chow J (as he then was); Practice Direction 34, §2(2).

6. A proposed appeal has a reasonable prospect of success if it is reasonably arguable, not that it will probably succeed: *China Mobile*, §16.

7. A finding of fact by the Board may only be challenged as an error of law on limited circumstances: *Kwong Mile Services Ltd v CIR* (2004) 7 HKCFAR 275, §§31-34, per Bokhary PJ.

8. There is no factual challenge in this application. Indeed, Mr Barlow SC, who appeared for the Taxpayer, had made that point emphatically and submitted that the Taxpayer is relying upon the factual findings of the Board.

9. Finally, the court should not disturb the Board's conclusion unless it regards that the conclusion is contrary to the true and only reasonable one: *Kwong Mile*, §37.

The Decision

10. A brief summary of the Decision is as follows. Further details of the Board's reasons will be dealt with when the grounds of appeal are addressed.

11. The issue before the Board was whether 3 sums of money paid to the Taxpayer by his former employer ("Company"), were chargeable to Salaries Tax under s.8 of the Ordinance.

12. Those sums were: (i) a 2010 incentive bonus payment ("Sum A"); (ii) a lump sum payment representing a pension entitlement ("Sum B"); and (iii) a lump sum payment representing variance in the stock valuation of shares options ("Sum C").

13. The background facts set out in the Decision, §§ 12.1 to 13, were either agreed by the Taxpayer or not in dispute.

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14. The Taxpayer was employed by the Company pursuant to a Letter of Employment dated 15 September 2006 (“Employment Letter”). Under the terms of the Letter, the Taxpayer’s employment package comprised of, *inter alia*, a base salary, performance bonus, and entitlement to a benefit to cover the Applicant’s pension with his previous employment.

15. The Taxpayer joined the Company on 1 December 2006. On 18 July 2010, he was informed by the Company that his employment would be terminated, but he was requested to stay on until the end of 2010 for smooth transition. The Taxpayer did stay on in the Company until January 2011 for that purpose.

16. On 27 January 2011, the Taxpayer and the Company signed an Agreement and Release (“Release Agreement”) which, *inter alia*, provided for the payment of the 3 Sums to the Taxpayer. It was provided in the Release Agreement that the Taxpayer’s employment officially ended on 14 January 2011 (“Termination Date”).

17. In respect of Sum A, the Board found that this payment arose as a reward for the Taxpayer’s employment services in 2010 and thus chargeable to Salaries Tax. In coming to this view, the Board considered, *inter alia*, the following :

- (1) A Salary Review Letter issued by the Company dated 7 June 2010 which confirmed the payment of Sum A as a result of the Applicant’s performance;
- (2) The Taxpayer’s own evidence on the fulfilment of performance targets on which Sum A was based;
- (3) A letter from the Taxpayer’s solicitors (“TDW”) dated 6 December 2010 (“TWD Letter”) asserting entitlement to this sum from the Company on the basis of his performance.

18. As regards Sum B, the Board found that the payment was made pursuant to Clause 12 of the Letter. The amount was ascertained at the time when the Taxpayer remained under the employment of the Company. It was an income from the Taxpayer’s employment with the Company and hence taxable.

19. The Board arrived at this conclusion after considering, *inter alia*, the following :

- (1) Clause 12 of the Letter (the material part of which will be set out below); and
- (2) The TDW Letter by which the Company was asked for payment of Sum B as a contractual entitlement of the Taxpayer.

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20. Sum C represented payment made to the Taxpayer in respect of variance of valuation of stock entitlements under the Employment Letter. The Board found that the Taxpayer's stock entitlements had been paid to him during his employment. Such entitlements were reported by him as employment income, and on which he had paid tax.

21. As Sum C represented payment of the adjusted valuation of such stock entitlements, the Board held that Sum C was income from the Taxpayer's employment and hence taxable.

22. In conclusion, the Board found that all 3 sums were income from employment, being payments made pursuant to the terms of the Employment Letter or as an inducement to the Taxpayer for continuing his service as an employee between July 2010 and January 2011.

The question of law

23. The single question of law advanced by the Taxpayer was formulated as follows (broken into sub-paragraphs for easier reading):

“UPON the true construction of:

- (a) part 3 of the Ordinance and in particular sections 8(1), 9 and 11B to 11D thereof;
- (b) the Taxpayer's employment contract; and
- (c) the Taxpayer's termination contract

AND UPON the facts agreed and found by the Board, including their findings that the Three Sums (in the Decision: Sum A, Sum B and Sum C) were paid to the Taxpayer following the execution of the termination contract after his employment had ceased

DID THE BOARD ERR IN LAW by holding that the Taxpayer received all 3 Sums pursuant to accrued contractual entitlements under the employment contract (and they therefore constituted Part 3 “*income*”) and not pursuant to contractual entitlements which only accrued upon the execution of the termination contract (which would not constitute Part 3 “*income*”)?”

24. There are 6 grounds of appeal advanced in the Statement. The first 2 grounds are generalised criticisms over the Decision alleging that the Board had failed to adequately take into account ss.11B to 11D of the Ordinance, the relevant appellate authorities and the provisions of the Employment Letter and the Release Agreement.

25. I do not believe that these 2 grounds are properly formulated points of law or proper particulars in support of the Question of Law set out in para 23 above (see

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the principles referred to in para 5 above). In any case, they add nothing to the specific grounds, Grounds 3 to 5, which address the Taxpayer's case on the 3 Sums.

26. Further, in the course of Mr Barlow's submission, the reliance upon s.11D of the Ordinance (an argument based on when the entitlement to the 3 Sums was accrued) was abandoned.

27. In the premises, it is unnecessary to deal with Grounds 1 and 2.

28. Ground 6 is similarly lacking in particularity. It is consisted of (i) repetition of the complaint about the Board's failure to understand relevant provisions of the Ordinance and appellate authorities; and (ii) assertions that the Board was confused over the evidence and contract law. Like Grounds 1 and 2, the generalised criticisms are not properly correlated with specific aspects of the reasoning of the Board.

29. The observations made in para 25 above over Grounds 1 and 2 apply also to this Ground. It should be added that there is no basis, and it is not part of the Taxpayer's case, to challenge any finding of facts by the Board. Ground 6 also does not warrant detailed analysis.

Sum A

30. I turn to the real arguments. Ground 3 stated as follows :

“Thirdly, in respect of Sum A, the Board erred in law in failing to hold that:-

(1st) On the Termination Date, when the Taxpayer's employment under the Employment Letter [ANNEXURE B hereto] ceased, he had no accrued legal entitlement to be paid Sum A because, as the parties agreed and the Board found (see para 8(3) and (5) above), any such entitlement could not accrue before March 2011 (similarly to the facts in the Elliott case).

(2nd) Within the Release Agreement, the Taxpayer agreed (see para 8(6)(a), (d) and (e) above plus clauses 2 and 5 of the Release Agreement – ANNEXURE C hereto), to surrender all legal rights and claims he might have (including for wrongful dismissal or other breaches of contract or statute) in exchange for the Company agreeing to pay him *inter alia* Sum A – the receipt and retention of which, he also agreed, was conditional upon him: (a) signing the Release Agreement (releasing the Company from all liabilities); and (b) not suing the Company later.

(3rd) By reason of the above, the Taxpayer had no accrued legal entitlement to claim payment of Sum A until the Release Agreement was executed on 27 January 2011 ie 13 days following

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the Termination Date when the Taxpayer's employment had ceased."

31. There are 3 points raised in Ground 3, namely, (i) the time when the right to Sum A accrued; (ii) the surrender of all the Taxpayer's rights and claims he might have in exchange for Sum A, the retention of which was conditional on his abidance with the bargain; and (iii) the Taxpayer had no accrued entitlement to Sum A until the execution of the Release Agreement which took place after the cessation of his employment.

32. Before dealing with the relevant part of the Decision on these points, it should be pointed out that the Board had properly addressed its mind on the applicable principles of law in Section B of the Decision. After referring to ss.8 and 9 of the Ordinance, it was stated in paras 7 to 11 as follows :

"7. A payment received by an employee from his employer is not necessarily income "from his employment" within the definition of section 9 of the Ordinance. (See: *Fuchs v Commissioner of Inland Revenue* (2011) 14 HKCFAR 74 at 81 [16])

8. Income chargeable under section 8(1) of the Ordinance is not confined to income earned in the course of employment but also embraces:

8.1. payment made "in return for acting as or being an employee";

8.2. payment made "as a reward for past services";

8.3. payment made "as an inducement to enter into employment and provide future services".

[*Fuchs* [17]; *Commissioner of Inland Revenue v Poon Cho-ming, John* [2019] HKCFA 38 [14]]

9. In considering the nature of payment, one shall look at the substance, but not merely the form, and shall not be "blinded by some formulae which the parties may have used". One is to look at the true purpose for which the payment was made, but not the parties' characterisation of such payment. [*Fuchs* [17-18]]

10. In cases where payment was made to an employee when the employment is brought to an end, it will often be plausible for an employee to assert that the payment was made to compensate for his abrogation of his employment rights and argue that the payment was not subject to salaries tax. The Court of Final Appeal in *Fuchs* acknowledged this situation and held that to

decide whether the above argument should be accepted, the operative test must be:

“In the light of the terms on which the taxpayer was employed and the circumstances of the termination, is the sum in substance “income from employment”? Was it paid in return for his acting as or being an employee? Was it an entitlement earned as a result of past services or an entitlement accorded to him as an inducement to enter into the employment? If the answer is “yes”, the sum is taxable and it matters not that it might linguistically be acceptable also to refer to it as “compensation for loss of office” or something similar. On the other hand, the amount is not taxable if on a proper analysis the answer is “No”. As the “abrogation” examples referred to above show, such a conclusion may be reached where the payment is not made pursuant to any entitlement under the employment contract but is made in consideration of the employee agreeing to surrender or forgo his pre-existing contractual rights.” [*Fuchs* [22]]

11. The principles and approaches set out in *Fuchs* were confirmed by both the Court of Appeal and Court of Final Appeal in *Poon*. We respectfully adopted and applied these principles, and asked ourselves the question: in light of the terms of the Appellant’s employment and the circumstances of the termination, what is, in substance, the true purpose of the payment of each of the Three Sums.”

33. The Board’s analysis on Sum A can be found in paras 53 to 66 of the Decision. In summary, the Board came to the view that the Taxpayer was entitled to the performance bonus as a reward for his employment services in 2010¹. The Salary Review Letter from the Company² dated 7 June 2010 which confirmed that the Company had approved the 2010 package to be paid to the Taxpayer, ie, Sum A as the performance bonus. As stated in the TWD Letter, the performance of the Company exceeded all targets by 30 November 2010 and the Taxpayer was entitled to Sum A. That statement was not disputed by the Company.

34. Further, in light of what the President of the Company had said to the Taxpayer at the meeting on 18 July 2010³ about the payment of full performance bonus to the Taxpayer if he remained in employment until the end of 2010, acted in cooperation with the Company during the IPO period and had a smooth transition of his role to the new CEO, all of which the Taxpayer had fulfilled, Sum A was also a payment to reward the Taxpayer for remaining in employment during the period from 18 July 2010 until the final termination date.

¹ See para 14 above on the terms of the Employment Letter.

² The terms of which were set out in the Decision, §56.

³ Evidence of the Taxpayer about the meeting can be found in the Decision, §§21-23.

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35. Importantly, the Board did not accept the Taxpayer's evidence that the Company retained a discretion over the performance bonus⁴, nor his evidence that the TDW Letter merely set out his negotiating position⁵.

36. In respect of the accrual of right over Sum A, according to the Salary Review Letter, it would be payable to the Taxpayer in the forms of cash and stock in March of the year following the performance year⁶. That should be March 2011, after the termination of the Taxpayer's employment with the Company. This is the kernel of the Taxpayer's submissions on this point.

37. With respect, I believe that the Taxpayer's contention ignored the distinction between the accrual of right to Sum A and when it became payable. Once it was accepted by the Company that the performance targets were met in 2010, there can be little doubt that the Taxpayer had earned the entitlement to Sum A. The only question was when it should be paid.

38. According to the TDW Letter, Sum A should be paid in cash to the Taxpayer upon termination of his employment because any stock awarded by way of annual compensation but not yet due would need to be paid out in case in any event under clause 5(b) of [the Employment Letter]⁷. There is no suggestion that TDW was wrong.

39. Hence, the submission of Ms Cheung, who appeared for the Respondent, that there was no acceleration of the receipt of Sum A by the Taxpayer is correct.

40. Ms Cheung submitted, without demur from the Taxpayer, that the Taxpayer's submissions based on ss.11B to 11D of the Ordinance were never made before the Board. It was noted in para 26 above that the point was abandoned by the Taxpayer. The concession was rightly made in view of the provisions of s.11D(b)(ii) as follows :

“... , any payment made by an employer to a person after that person has ceased or been deemed to cease to derive income which, if it had been made on the last day of the period during which he derived income, would have been included in that person's assessable income for the year of assessment in which he ceased or is deemed to cease to derive income from that employment, shall be deemed to have accrued to that person on the last day of that employment.”

41. In the premises, I fail to see why the Taxpayer's entitlement to Sum A did not accrue during his employment. For completeness, I do not believe that a proper

⁴ Decision, §63.

⁵ Decision, §64.

⁶ Decision, §12.9 (part of the Agreed Facts).

⁷ Decision, §61 and §12.3.4(ii) for clause 5(b) of the Employment Letter. The Employment Letter can be found in tab 3.2 of the Hearing Bundle.

reading of the Decision supports the contention (see Ground 3 (1st)) that the Board had found that such entitlement could not accrue before March 2011.

42. As regards the surrender of the Taxpayer's rights pursuant to the terms of the Release Agreement, it was clearly a matter taken into account by the Board⁸.

43. Most importantly, the Board had identified and correctly applied the law in considering the true purpose of the payment which Sum A represented by looking at the substance and not blinded by some formulae or characterisation used by the parties⁹.

44. Paragraphs 16 to 18 of the Decision stated as follows :

“16. The Three Sums were payments made after the effective termination of the Appellant's employment, and were stated as part of the payments made under the Release Agreement. Nonetheless, as held in *Fuchs* and *Poon*, these payments will be subject to the Salaries Tax if their true purpose are income from the employment.

17. The Appellant put forward as one of his grounds of appeal a proposition that where there is a written termination (the Release Agreement in the present case), the purpose for which a payment was made is to be gleaned from the Release Agreement itself (See paragraph 3.4 above). The proposition is in contradiction with the decision of *Fuchs*.

18. As enunciated by the Court of Final Appeal in *Fuchs* and confirmed in *Poon*, determination of the substance and true purpose of the payment in question shall not be blinded by the formulae used by the parties or the parties' characterisation of these payments. The purpose of the payments shall be considered “in light of the terms on which the taxpayer was employed and the circumstances of the termination” [*Fuchs* [22]]”

45. The Board went on to consider at length the relevant circumstances on which its decision on the true purpose of the payments (Sums A, B and C) was based.

46. I see no substance in the criticism by the Taxpayer based on the terms of the Release Agreement.

47. The above analysis sufficiently covers the Taxpayer's point (iii) (see para 31 above).

⁸ Decision, §12.11.

⁹ Decision, §§9-11 set out under para 32 above.

Sum B

48. Ground 4 stated as follows :

“Fourthly, in respect of Sum B, the Board erred in law in failing to hold that:-

(1st) As can be seen from para s 8(1)(f) and 16(7) above, in clause 12 of the Letter Agreement [ANNEXURE B hereto], the Company merely agreed to “*address*” the possibility of compensating the Taxpayer for his forfeited AXA pension, which, during the 4¼ years of the employment, did not result in any agreement to pay any such compensation – also, see the authorities cited in para 15 above. Thus, on the Termination Date, the Taxpayer had no accrued entitlement to be paid Sum B.

(2nd) [Ground 3] (2nd) above is repeated *mutatis mutandis*.

(3rd) [Ground 3] (3rd) above is repeated *mutatis mutandis*.

49. The Release Agreement and the accrual point under Ground 3 (3rd) have been sufficiently dealt with above. The kernel of Ground 4 is clause 12 of the Employment Letter and the contention that no agreement was reached pursuant thereto. Consequently, the Taxpayer had no accrued entitlement to Sum B on the Termination Date.

50. Clause 12 of the Employment Letter stated as follows¹⁰ :

“The issue on [the Taxpayer’s] pension scheme with [his former employer] will be addressed under separate cover subject to [the Taxpayer’s] submission of written documentation with all the scheme details.”

51. The Board’s reasons on Sum B can be found in paras 67 to 75 of the Decision. In summary :

(1) Clause 12 was a term of employment made to induce the Taxpayer to provide employment services to the Company¹¹;

(2) The Taxpayer had submitted the documentation according to Clause 12 and the pension amount was assessed at a value of US\$520,000 (Sum B)¹²;

¹⁰ Decision, §68.

¹¹ Decision, §69.

¹² Decision, §70.

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- (3) The TDW Letter stated that the Taxpayer was entitled to Sum B pursuant to Clause 12 of the Employment Letter and the collateral agreement that the Taxpayer was to be reimbursed a sum equivalent to his pension entitlement prior to his departure from his former employer. The Letter also stated that the Taxpayer was contractually entitled to Sum B and he had received a number of assurances from the Company that it would be paid (referring to the Taxpayer's conversations with the management of the Company and contemporaneous correspondences supporting the Company's commitment to pay the sum)¹³;
- (4) The Board did not accept the Taxpayer's argument that Clause 12 only addressed the possibility of paying him the pension sum¹⁴;
- (5) The Board found that Sum B was made pursuant to Clause 12. The amount was assessed and ascertained at the time when the Taxpayer was still in employment. It was an income from his employment with the Company and was taxable¹⁵.

52. In light of these reasons, in particular, it was not in dispute that the Taxpayer had submitted the documentation required under Clause 12 and the pension was assessed at Sum B, it is different to understand the complaint under Ground 4 (1st).

Sum C

53. Ground 5 stated as follows :

“Fifthly, in respect of Sum C, the Board erred in law is (sic) failing to hold that:-

- (1st) As can be seen from para 8(1)(c) above and from clause 5 of the Letter Agreement (ANNEXURE B hereto), it conferred no legal entitlement on the Taxpayer to be compensated for the valuation variance. Thus, on the Termination Date, the Taxpayer had no accrued entitlement to be paid Sum C.
- (2nd) [Ground 3] (2nd) above is repeated *mutatis mutandis*.
- (3rd) [Ground 3] (3rd) above is repeated *mutatis mutandis*.

¹³ Decision, §71.

¹⁴ Decision, §73.

¹⁵ Decision, §75.

54. The only point which requires analysis is the contention that clause 5 of the Employment Letter conferred no legal entitlement on the Taxpayer to be compensated for valuation variance.

55. The reasoning of the Board was stated in succinct terms in paras 76 and 77 of the Decision as follows :

“76. Sum C is a payment representing the variance of valuation of stock (including RSU¹⁶ and LTPU¹⁷) entitlement under the Employment Letter. These stock salaries were paid to the [Taxpayer] during his employment and were duly reported by him as employment income. The [Taxpayer] had paid tax thereon.

77. The payment of Sum C is the variance on the valuation of the stock salaries already paid to the [Taxpayer], but not with respect to the granting or vesting of any stock units to the [Taxpayer] after the employment. The obligation under the Employment Letter was to pay the [Taxpayer] the stock salaries. It must mean that the Company shall pay the correct valuation as adjusted. We found that Sum C was an income from the [Taxpayer’s] employment service.”

56. Whilst it is true that the Employment Letter had made no provision for the payment of valuation variance, I am unable to see how the analysis of the Board can be faulted. Plainly, the true purpose of Sum C was to remunerate the Taxpayer for the service he rendered in the course of employment.

Conclusion and disposition

57. For these reasons, there is no merit in this leave application. It is declined with an order *nisi* that the costs of and occasioned by the application be paid by the Taxpayer.

(Anthony Chan)
Judge of the Court of First Instance
High Court

Mr Barrie Barlow SC, instructed by MinterEllison LLP, for the Applicant
Ms Diana Cheung, instructed by Department of Justice, for the Respondent

¹⁶ Restricted Stock Units.

¹⁷ Not defined in the Decision.