

**Case No. D17/23**

**Salaries tax** – whether termination payments were chargeable to salaries tax – whether payments were for past services or compensation for loss of office – whether payments under incentive plans were taxable – section 8(1), section 9(1), and section 68(4) of the inland revenue ordinance

Panel: Hau Pak Sun (chairman), Lee Hong Yee Connie and Lee Wong Wai Ling Winnie.

Date of hearing: 26 October 2022.

Date of decision: 22 January 2024.

The Appellant objected to the salaries tax assessment for the year of assessment 2013/14, asserting that payments received upon termination of her employment should not be chargeable to salaries tax.

The disputed sum amounted to US\$1,155,723 (HK\$8,930,133) and consisted of short-term incentive plan (STI payments) of US\$200,000, long-term incentive plan (LTI payments) of US\$652,935, and other payments, including payment enhancement of US\$202,788, consulting fee and expenses of US\$75,000, and deal bonus of US\$25,000.

The Appellant argued that the relevant sums were paid in consideration of signing a separation agreement that required her to waive legal claims against her employer, including alleged wrongful termination. She contended that these payments were compensation for loss of office rather than remuneration for past services. She further claimed that the STI and LTI payments were non-contractual and discretionary and should not be considered taxable income. Additionally, she asserted that the other payments were severance-related or compensation for professional expenses rather than rewards for employment services.

**Held:**

1. The board held that the burden of proof under section 68(4) of the Inland Revenue Ordinance rested on the Appellant to prove that the assessment was excessive or incorrect. The board found that the Appellant failed to provide sufficient evidence to support her claim that the payments were not taxable.
2. Applying the principles in Fuchs v CIR (2011) 14 HKCFAR 74 and CIR v Poon Cho Ming, John (2019) 22 HKCFAR 344, the board ruled that the STI and LTI payments were remuneration for past services and not

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compensation for loss of office. The nature of the incentive plans indicated that these payments were earned during employment.

3. The board also found that the Appellant failed to establish any enforceable legal claims against her employer that could justify classifying the payments as settlement sums. The employment contract was terminable with three months' notice or payment in lieu, and the Appellant did not initiate any legal proceedings nor provide evidence of a credible legal claim. The existence of a waiver clause in the separation agreement did not, in itself, recharacterize the payments as compensation for loss of office.
4. Regarding the other payments, the board concluded that the deal bonus was directly tied to the completion of a business sale and was therefore a reward for services rendered. The payment enhancement, though discretionary, functioned as a gratuity for services and was therefore taxable. The consulting fee and expenses were not incurred for legal advice as claimed by the Appellant, and no documentary evidence was provided to support this assertion.
5. The employer reported the payments as taxable income in form IR56F, and the board found no basis to override this classification. The Appellant did not present compelling evidence to suggest that the employer's tax treatment was incorrect.
6. The appeal was dismissed, with the board concluding that the STI and LTI payments were remuneration for past services and chargeable to salaries tax, and that the other payments were rewards for employment services rather than compensation for loss of office. The Appellant failed to discharge the burden of proof to show that any part of the payments was non-taxable.

**Appeal dismissed.**

Cases referred to:

Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74  
Commissioner of Inland Revenue v Poon Cho Ming, John (2019) 22 HKCFAR 344  
Heath Brian Zarin v the Commissioner of Inland Revenue [2020] 2 HKLRD 229  
D24/14, (2015-16) IRBRD, vol 130,153  
D4/21, (2021-22) IRBRD, vol 36, 311  
D12/11, (2011-12) IRBRD, vol 26, 220

Appellant in person.

Cheng Nga Man, Fung Chi Keung, Lee Shun Shan and Wong Hoi Ki, for the Commissioner of Inland Revenue.

**Decision:**

1. Miss A (**‘the Appellant’**) has objected to the Salaries Tax Assessment for the year of assessment 2013/14 raised on her. The Appellant claims that certain sums she received upon termination of her employment should not be chargeable to Hong Kong Salaries Tax (**‘Salaries Tax’**).

2. The sum in dispute in this appeal concerns the chargeability of the total amount of US\$1,155,723 (equivalent to about HK\$8,930,133) (**‘the Relevant Sums’**) received by the Appellant from her employer at termination of employment, which consisted of:

- (1) Sums representing payments to the Appellant from her participation in her employer’s annual incentive program (ie Short Term Incentive Plan (**‘STI Plan’**)) totaling US\$200,000 (collectively referred to as **‘STI Payments’**);
- (2) Sums representing payments to the Appellant from her participation in the Long Term Incentive Plan (**‘LTI Plan’**), totaling in the amount of US\$652,935 (**‘LTI Payments’**); and
- (3) Other sums (**‘Other Payments’**), which were respectively categorized as:
  - a. ‘Payment Enhancement’ in the sum of US\$202,788;
  - b. ‘Consulting Fee & Expenses’ in the sum of US\$75,000; and
  - c. ‘Deal Bonus’ in the sum of US\$25,000.

**Background Facts**

3. The significant facts and events relevant to this appeal are summarized below.

4. On 1 December 2008, the Appellant commenced her employment with Company B (then known as Company C) (**‘the Employer’**) as Position D, Department E, Asia. The Appellant’s employment was first governed by an employment contract dated 31 October 2008 (**‘the 2008 Contract’**). The Employer was incorporated in the United States of America. It was registered in Hong Kong as a non-Hong Kong company in 2003 and ceased its business in Hong Kong on 28 February 2014.

5. On top of her salary, which was initially US\$250,000 per annum, the Appellant would also be entitled to as part of her employment package with the Employer:

- (1) participate in the STI Plan that provided for a bonus payment equivalent to a percentage of her base salary, dependent on

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performance in the past year of her own, the Employer and its parent company, Company F (**'the Parent Company'**), as determined by the management; and

- (2) participate in the LTI Plan, which provided for 3-year consecutive award cycles, with a new cycle starting every year on 1 January. The actual value at the end of the period would vary up or down based on business performance of the Employer and the Parent Company.

6. The payments to the Appellant under the STI Plan and LTI Plan were subject to:

- (1) The Appellant was an employee in good standing and employed at the Employer at the time of payment for the STI Plan; and
- (2) The Appellant had not been terminated for cause or voluntarily terminated her assignment at the time of payment of the LTI Plan.

7. In 2010, the Employer advised in its letters dated 1 June 2010 and 17 December 2010 to the Appellant (**'the 2010 Letters'**) that there would be sale of its operations in Hong Kong, Korea and Taiwan (**'Project G'**). Since the Appellant was a valued member of the management team, the Employer asked the Appellant to continue in her current position to assist in the successful completion of the sales for which she would be given ex-gratia payment under the STI Plan upon completion of sales (**'G Bonus'**) and enhanced severance payment upon termination of employment, provided that the Appellant remained employed by the Employer until the date of completion of the last sale and met other conditions. Also, the Employer made it clear that the 2010 Letters did not give the Appellant any right to continued employment with the Employer or any of its affiliates. The Appellant signed the 2010 Letters confirming her acceptance to their terms and conditions.

8. On 27 October 2010, the Hong Kong and Korea operations of the Employer were sold.

9. On 24 March 2011 by a new employment contract (**'the 2011 Contract'**), the Employer offered the Appellant a new position of Position H, Position J to commence on or around 1 April 2011, initially based in Hong Kong and expected to be relocated to City K in second half of 2011.

10. In around October 2011, the Appellant was advised by the Employer that the Appellant's role would be made redundant after the proposed sale of the Taiwan business and the option to relocate the Appellant to City K was cancelled. The Appellant therefore remained in Hong Kong for the same position until the sale of Taiwan business.

11. In late 2011, the sale of the Taiwan business failed to be approved by the regulator and the Appellant 'had to stay on to find another buyer'. Eventually, on 25 June 2013, the Employer sold its operation in Taiwan.

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12. In mid-2013, the Appellant was informed by the management of the Employer of their intention to terminate the Appellant's employment.

13. On 28 February 2014, the Employer ceased its business in Hong Kong.

14. On 13 March 2014, the Appellant signed a Confidential Agreement and General Release dated 7 March 2014 with the Parent Company ('**Separation Agreement**'), which provided that the Appellant's employment with the Employer was terminated due to job elimination effective 31 January 2014. Among other payments, the Relevant Sums were made to the Appellant upon her job elimination date on 31 January 2014.

15. Throughout the Appellant's employment with the Employer, bonus formed a significant part of the Appellant's remuneration. Since year of assessment 2009/10 and before 2013/14, the Appellant received the following bonus in the following years of assessment:

<u>Year of assessment</u>	<u>Amount of bonus</u>
2009/10	HK\$1,756,376
2010/11	HK\$2,289,059
2011/12	HK\$6,067,517
2012/13	HK\$4,197,104

### **The Appellant's Grounds of Appeal**

16. The Appellant's grounds of appeal can be summarized as follows:

- (1) The Relevant Sums were paid to the Appellant for entering into the Separation Agreement. They were paid in consideration of the Appellant's agreeing to waive her rights of actions/ claims against the Employer and to comply with the terms of the Separation Agreement. In particular, the Appellant seeks to argue that the Relevant Sums were paid to her for waiving and releasing her employer with respect to:
  - a. The Appellant's potential claims for:
    - i. Termination based on discrimination;
    - ii. Constructive dismissal; and
    - iii. Termination of employees that potentially breach internal HR policies and procedures;
  - b. The Appellant's right to sue for breach of promise for relocation her to City K to continue her employment; and

- c. For her agreement to comply with the agreement to comply with the general release terms stated in the Separation Agreement, not to sue the Parent Company under all sorts of grounds or not to ‘create a fuss’.

**(‘the Release Grounds’)**

- (2) The STI Payments and LTI Payments were non-contractual payments and the amount of the payments well exceeded her entitled amount pursuant to the 2011 Contract. The accrued rights to receive these payments were on the condition that the Appellant remained an employee of the Employer (**‘the LTI and STI Payments Ground’**); and
- (3) The Other Payments were non-contractual payments and were not paid for the Appellant’s services:
  - a. ‘Payment Enhancements’ has the same nature as payments from the Employer categorized as ‘Enhanced Severance Benefit’ and ‘Special Leader Severance Benefit’ which were **not** assessed to Salaries Tax for the year of assessment 2013/14 and therefore should be subject to the same tax treatment;
  - b. ‘Consulting Fee and Expenses’ were the consulting fee paid by the Appellant for obtaining legal advice; and
  - c. ‘Deal Bonus’ was a bonus paid in relation to the Appellant’s work on the sales of business.

**(‘the Other Payments Ground’)**

**The Relevant terms of the Appellant’s employment and the Separation Agreement**

***The 2008 Contract and the STI and LTI Plan***

17. The material terms of the 2008 Contract provides:
- (1) The Appellant's base salary would be USD250,000 per annum, payable over twelve months (Clause 1);
  - (2) In March 2009 and each year thereafter, the Appellant would be eligible to participate in the STI Plan that provided for a bonus payment equivalent to a percentage of her base salary, dependent on performance in the past year of her own, the Employer and the Parent Company, as determined by the management (the award granted under STI Plan is referred as ‘STI’). Payouts were made in March following the plan year on the condition that the Appellant was an

employee in good standing and employed at the Employer at the time of payment (Clause 2);

- (3) The Appellant would be eligible to participate in the LTI Plan. There were 3-year consecutive award cycles for the LTI Plan, with a new cycle starting every year on 1 January (the award granted under LTI Plan is referred as 'LTI'). The actual value at the end of the period would vary up or down based on business performance of the Employer and the Parent Company. The final award might increase up to two times the grant value for maximum results for the applicable period. At the end of the three-year cycle, grants were valued against business results and paid out in equal instalments over a 3-year period starting in March of the year following the end of the cycle, provided that the Appellant had not been terminated for cause or voluntarily terminated her assignment (Clause 3);
- (4) Either the Employer or the Appellant might terminate her employment with the Employer by providing three months' notice (excluding any accumulated annual leave entitlement) or three months' salary in lieu of notice (Clause 8);
- (5) The Appellant was expected to maintain confidentiality with respect to all information relating to the affairs of the Employer and its related companies, and its and their respective offices, employees, agents, suppliers and customers, which came to the Appellant's knowledge in the course of her employment and her obligation of confidentiality would be effective both during and after her employment with the Employer (Clause 9);
- (6) The Appellant agreed that rules, policies, codes, procedures and handbook (if any) relating to employees of the Employer as might from time to time be provided to her by the Employer should form, and should be deemed to form, an integral part of the 2008 Contract (Clause 10);
- (7) The 2008 Contract was governed by Hong Kong law (Clause 10).

18. According to the LTI Plan, the LTI should be forfeited and cancelled if the participant's employment with the Employer ceased for any reason or was involuntary terminated for cause (Section 6(a) of the LTI Plan). Notwithstanding so, at the discretion of the Chief Executive Officer of the Employer, the LTI should become 100% vested upon the participant's involuntary termination of employment (other than for cause), or termination of employment upon mutual agreement or the Employer and the participant (Section 6(d) of the LTI Plan).

19. Similar to the LTI Plan, a participant of the STI Plan may still at the discretion of the compensation committee set up as defined in the STI Plan receive all or a

portion of the STI notwithstanding the participant has terminated his/her employment as if he/she had remained employed.

***The 2010 Letters***

20. The material terms of the 2010 Letters provided:

- (1) The G Bonus would be an amount equal to 75% of the Appellant's annual base salary plus her target annual bonus under the STI Plan (Clause 1);
- (2) Upon termination of the Appellant's employment with the Employer (other than for cause or due to her voluntary resignation), the Appellant would be entitled to the following payments (Clause 2.1):
  - a. an enhanced severance payment, payable within 7 days after the date of termination, equal to the greater of (i) one month's base salary (as at the date of termination) for each year of continuous service with the Employer (pro rata for incomplete years of service), not to exceed 12 months' base salary or (ii) six months' base salary (as at the date of termination), in each case which was inclusive of the Appellant's statutory long services or severance payment, if any, (calculated as  $\frac{2}{3} \times \$22,500 \times$  each year of continuous service, pro-rated for partial years) to which the Appellant might be entitled under the Employment Ordinance ('EO') and any other severance payment to which she might be entitled under the terms of her employment contract (Clause 2.1(a));
  - b. an ex-gratia payment in lieu of the discretionary annual bonus under the STI Plan equal to a pro-rata portion of the Appellant's annual incentive bonus under the STI Plan for the year in which the earlier of the 60<sup>th</sup> day after the date of completion of the sale of the Employer's Taiwan affiliate or 30 September 2011 ('**the Completion Date**') occurred, based on her STI Plan target for such year, payable within 30 days after the date of termination (Clause 2.1(b)); and
  - c. payment of any unpaid balance of amounts awarded in respect of closed performance periods under the LTI Plan contemplated in the Appellant's current employment contract, payable within 30 days after the date of termination (Clause 2.1(c)).
- (3) The payments under Clauses 1 and 2.1 above would be subject to the satisfaction of each of the following conditions (Clause 3):



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- a. the Appellant should remain continuously employed by the Employer from 1 June 2010 until the Completion Date, unless her employment was terminated by the Appellant without cause (Clause 3(a));
  - b. the Appellant should not give notice to terminate the Appellant's employment for cause on or before the Completion Date (Clause 3(b));
  - c. the Employer should not give notice to terminate the Appellant's employment for cause on or before the Completion Date (Clause 3(c));
  - d. the Appellant should sign a Confidentiality Agreement and Release on terms reasonably satisfactory to the Employer (Clause 3(d)).
- (4) The 2010 Letters were governed by the laws of Hong Kong (Clause 5(c)).

21. The material terms of the 2011 Contract provided that:

- (1) The Appellant's annual base salary would be USD250,000, payable biweekly. Starting from 1 January 2012, her base salary would be increased to USD285,000. In March 2012, and each year thereafter on a date set by the Board of Managers, her salary would be reviewed as part of the annual salary review process (Clause 1);
- (2) The Appellant would be eligible to participate in the STI Plan. Her targeted payout under the plan for 2011 was 45% of 2011 base salary which might be adjusted up or down depending on the performance of her own, the Employer and the Parent Company during the year. Management discretion would be applied in determining payouts, taking into consideration plan participation dates, performance and any other applicable offer terms. Payments were made in March (no later than 15 March) following the plan year, on the condition that the Appellant was employed at the Employer (or an affiliate) at the time of payment. The Compensation Committee of the Employer's Board of Managers might modify or discontinue the STI Plan at any time (Clause 1);
- (3) The Appellant would receive a One-time Bonus of USD185,000 if she signed the One-Time Bonus Agreement (Clause 1);
- (4) The Appellant would continue to participate in the LTI Plan. The Appellant's targeted payout under the plan would be increased to USD150,000 beginning with the 2009-2011 cycle. The actual value

at the end of the period would vary up or down based on business performance of the Employer and the Parent Company. The final award might increase to two times the grant value for maximum results for the applicable period. Each award cycle lasted for three full years. In general, at the end of the three-year cycle, grants were valued against business results, and then paid in accordance with that cycle's payout schedule. Beginning with the 2010-2012 cycle, payouts were made in full in March of the year following the end of the cycle (no later than 15 March). For all previous cycles, grants were valued against business results and then paid out over the following three years in 1/3 increments starting in March of the year following the end of the cycle (no later than 15 March), provided that the Appellant was employed by the Employer (or an affiliate) on the payment date and had not engaged in impermissible activities as described in the LTI Plan. The Compensation Committee of the Employer Board of Managers might amend or terminate the LTI Plan at any time (Clause 2);

- (5) While the Appellant remained employed in Hong Kong, either the Appellant or the Employer might terminate her employment with the Employer by providing three months' written notice or payment in lieu of notice (Clause 6);
- (6) The Appellant was expected to maintain confidentiality with respect to all information relating to the affairs of the Employer and its related companies, and its and their respective offices, employees, agents, suppliers and customers, which came to the Appellant's knowledge in the course of her employment and her obligation of confidentiality would be effective both during and after her employment with the Employer (Clause 7);
- (7) The Appellant should observe and comply with all rules, policies, codes, procedures and handbooks (if any) relating to employees of the Employer as might from time to time be provided to her by the Employer, which, if so indicated, would form part of the terms and conditions of her employment and be incorporated into her employment contract; and
- (8) The 2011 Contract cancelled and was in substitution for all previous letters of engagement, agreements and arrangements whether oral or in writing relating to the subject matter thereof between the Employer and the Appellant (except the 2010 Letters regarding the G Bonus), all of which should be deemed to have been terminated by mutual consent.

22. The material terms of the Separation Agreement provided that:

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- (1) On the condition that the Appellant signed and did not revoke the Separation Agreement and complied with its terms, she would be provided, among other things, the following sums:
  - a. The sum of USD651,577, less applicable deductions, which was the Appellant's Enhanced Severance Benefit, Supplemental Severance Benefits and other payments (including any applicable Hong Kong Special Administrative Region statutory payments);
  - b. The value of the Appellant's award under the LTI Plan of the Parent Company, with respect to each of the 2011-2013, 2012-2014 performance periods under the Parent Company's LTI Plan, pro-rated to reflect the actual time that she was employed during each performance period. The pro-rated value of her award under the Parent Company's LTI Plan with respect to the 2011-2013 and 2012-2014 performance period would be paid to her in a lump sum no later than 15 March 2014 and 15 March 2015 respectively, all subject to valid previous deferral elections;
  - c. The value of the Appellant's award under the Employer's LTI Plan with respect to the 2011-2013 performance period, pro-rated to reflect the actual time that she was employed during the performance period. The pro-rated value of her award under the Employer's LTI Plan with respect to the 2011-2013 performance period would be paid to her in a lump sum no later than 15 March 2014 subject to previous valid deferral elections;
  - d. The value of the unpaid balance of the notional or bookkeeping account maintained under the Parent Company and the Employer's LTI Plans on the Appellant's behalf with respect to the unvested and unpaid pre-2011 performance adjusted awards, as defined under the applicable plan documents, within ninety days of her termination, subject to valid previous deferral elections;
- (2) In exchange for providing the Appellant with the payments particularized in subparagraph (1) above, the Appellant agreed to waive all claims against the Parent Company and its subsidiaries, and release and discharge the Parent Company and its subsidiaries from liability for any claims or damages that she might have against them as of the effective date of the Separation Agreement, whether known or unknown to the Appellant. The Appellant understood that any payments or benefits provided to her under the terms of the Separation Agreement did not constitute an admission by Parent Company and

its subsidiaries that they had violated any law or legal obligation with respect to any aspect of her employment or termination therefrom.

- (3) The Appellant agreed that she should not use or disclose any attorney-client privileged, confidential or proprietary information of the Parent Company and its subsidiaries concerning the business, employees, operations, systems, finances, resources, legal matters, clients or prospects at any time for any purpose whatsoever, except that she was permitted to respond to a validly issued and served subpoena compelling her testimony and in such a situation, she agreed to provide notice to Parent Company and its subsidiaries of the service of such subpoena.
- (4) The Appellant agreed that she would not publicly or privately, disparage the Parent Company and its subsidiaries or any of their current or former officers, directors, trustees, employees, agents, administrators, representatives or fiduciaries.
- (5) The Separation Agreement should be interpreted for all purposes consistent with the laws of the State of City K.

23. Another relevant document in the Appellant's employment was the Job Elimination Severance Benefit Plan adopted by the Parent Company which provided severance benefit to its employees who were involuntarily terminated due to job elimination:

- (1) A Summary Plan Description dated 17 February 2012 concerning Parent Company's Job Elimination Severance Benefit Plan (**'Job Elimination Plan 2012'**) stated, among other things, the following:
  - a. Upon involuntary termination due to job elimination, the eligible employee would be paid for a Basic Severance Benefits (ie 2 weeks' pay), Enhanced Severance Benefit (ie 3 weeks' pay for the 1<sup>st</sup> year plus 2 additional weeks' pay for each additional year of service up to a maximum of 52 weeks' pay), Supplemental Severance Benefit (ie the Employee Performance Award, Management Performance Award or Executive Incentive Payment with respect to the preceding calendar year) and a Special Leadership 2012 Severance Benefit (ie USD2,000 per each completed year of service);
  - b. If an employee was eligible to the Basic Severance Benefits, he/she would automatically be paid in one lump-sum cash payment within 90 days after his/her involuntary termination due to job elimination, but in no event later than 15 March of the following calendar year. He/she was not required to do anything to receive such payment;

- c. If an employee was eligible to Enhanced Severance Benefit, Supplemental Severance Benefits and/or Special Leadership 2012 Severance Benefit, he/she would receive an ‘Agreement and General Release’ from the plan administrator. If he/she agreed to the terms of that agreement, he/she needed to sign it in the presences of a notary public and return it within 45 calendar days after his/her involuntary termination. He/she would have 7 calendar days after execution of that agreement to revoke it;
  - d. The Enhanced Severance Benefit, Supplemental Severance Benefits and/or Special Leadership 2012 Severance Benefit would be paid to the employee either in a single lump-sum cash payment within 90 days after expiration of the 7-day period described in sub-paragraph (c) above or in a number of equal instalment payments.
- (2) The Summary Plan Description dated 1 January 2014 concerning the Parent Company's Job Elimination Severance Benefit Plan (**‘Job Elimination Plan 2014’**), and together with the Job Elimination Plan 2012, the **‘Job Elimination Plans’**) was materially same as that for the Job Elimination Plan 2012, except that there was no provision for the Special Leadership 2012 Severance Benefits.

**Relevant contemporaneous employer’s notification and correspondence with the Inland Revenue Department (‘IRD’) on the Relevant Sums**

24. In the Employer’s notifications (**‘Form IR56Fs’**) furnished to the IRD in respect of the Appellant’s income from 1 April 2023 to 31 January 2014, the Relevant Sums was stated to be ‘Other Rewards, Allowances or Perquisites eg Bonus, Education Benefits, Shares’. The Relevant Sums was reported in two Form IR56F – in the 1<sup>st</sup> Form IR56F, ‘Other Rewards’ was a sum of HK\$7,321,045 which consists of the entire Relevant Sums apart from the 2012 to 2014 LTI Payment; in the 2<sup>nd</sup> Form IR56F the ‘Other Rewards’ was a sum of HK\$1,609,088 which was the 2012 to 2014 LTI Payment.

25. On the other hand, the Appellant claimed that the ‘Other Rewards’ for the same period was compensation for loss of office and should not be chargeable to Salaries Tax. In pursuance of her claim, the Appellant put forth the following contentions in letter to the IRD dated 10 February 2015:

- (1) The Employer had been operating in 8 countries outside the United States with its regional headquarter in Hong Kong. The Appellant was employed as a Position D based in the Hong Kong office in 2008;
- (2) In 2010, the Employer decided to divest most of its international businesses and close the regional headquarter in Hong Kong. The

Appellant was then offered by the Employer to take up a role with a proposed new business entity in the US. The Appellant would also be responsible to support the selling off and close down of the Hong Kong office. The 2011 Contract was signed in that context;

- (3) However, before the Appellant could be properly relocated to the United States, the Employer had abandoned its plan to start a new business in the United States and most of its employees were laid off. The Appellant therefore remained in Hong Kong until the sale of the Employer's last international business in Taiwan;
- (4) In January 2014, the Employer's business was formally closed down and the Appellant was laid off;
- (5) With the exception of a severance payment made to her as required by the local rules, the majority of the payments were entirely conditional upon the Appellant signing of the Separation Agreement and waiving of all her rights to make claims against the Employer. The payments were not made pursuant to any entitlements under her employment contract but were made in consideration of her agreeing to surrender or forgo her pre-existing contractual rights, ie the loss of right on one side and a legal liability on the other to pay compensation for the loss of such right; and
- (6) Redundancy payments made to her were not emoluments from employment but compensation for not receiving emoluments from the employment anymore. If the sum was not paid as a reward for her past services or as an inducement to enter into employment and provide future services but for other reasons, the sums were not a payment from her employment and should not be taxable.

26. In response to IRD's enquires, the Employer (through its tax representative KPMG Tax Services Limited ('**KPMG**')) provided, among other things, the following information:

- (1) The Employer's business was restructured in 2014. It exited the international market and sold its business in Hong Kong making all the employees of the Employer in Hong Kong redundant. The exit from the international market also reduced the scale of the Employer's global operations and, as a result, the Employer was not able to integrate an employee of the Appellant's seniority into its remaining business in City K. As such, the Employer decided to make the Appellant redundant. The termination of the Appellant's employment was part of a wider restructuring impacting all Hong Kong based employees;

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- (2) Except the Separation Agreement, there was no exchange of correspondence in negotiating the quantum of the termination payments. In determining the quantum of the termination payments, the Employer's senior management had taken into account of various factors, such as seniority, years of services and the employee's individual situation. The Severance Benefits was neither made in accordance with any terms in the employment contract nor the EO. In accepting the Severance Benefits, the Appellant agreed to accept the terms in the Separation Agreement and release all claims she had and might have had against the Employer. The payment was made in respect of a loss of rights and not as a reward for services;
- (3) The 'Other Rewards' of HK\$7,321,045 reported in the 1<sup>st</sup> Form IR56F included bonus and cash allowances paid to the Taxpayer and was chargeable to Salaries Tax in Hong Kong;
- (4) Based on the Job Elimination Plan 2014, Basic Severance of US\$10,962 was the standard severance payment from the Employer which consisted of two weeks' pay. The Enhanced Severance Benefit of US\$71,250 was computed according to the Appellant's year of services;
- (5) Concerning the 'Payment Enhancement' of US\$202,788, it was the Employer's practice but not a policy that, for executive member, if the severance payment computed under the Job Elimination Plans based on his/her number of service years was less than his/her 52 weeks' pay, a discretionary payment would be made to him/her to ensure he/she got a minimum of 52 weeks' pay as total severance payment;
- (6) For the 'Consulting Fees and Expenses' of US\$75,000, it should be paid to the Appellant to assist in an ad hoc capacity after her redundancy with transitional issues as the Employer's Hong Kong operations wound down;
- (7) In general, 'Deal Bonus' was paid to an employee for her to stay with the company for a certain period to complete a deal of the company;
- (8) The payment of LTI was subject to vesting conditions and would be forfeited upon cessation of employment. However, there were certain situations where the unvested payment would not be forfeited, including, as in the present case, an employee ceased his/her employment due to redundancy. For such reason, the Appellant could still receive her LTI after cessation of her employment;
- (9) There was no breach in legal or contractual obligations in the termination of the Appellant's employment; and

- (10) The Employer was not required to make any payment in lieu of notice to the Appellant as it had provided more than 3-month of notice to her in respect of her termination.

### **The Appellant's evidence**

27. The Appellant testified at the hearing in person. Neither the Commissioner nor the Appellant called other witnesses.

28. In terms of education and professional background, the Appellant obtained her law degree from the University L in 1986 and subsequently a Master of Business Administration from the University M in City N. The Appellant was a veteran in the life insurance business. Prior to joining the Employer, the Appellant had been employed in Hong Kong since 2003 in a number of different roles in life insurance business, notably at one time she was a Position J in products.

29. The Appellant joined the Employer in 2008 and had become a very valuable employee. When the Employer proceeded with the Project G in the sale of its operations in Hong Kong, Korea and Taiwan, the Employer kept the Appellant to assist in the successful completion of the transaction and offered her transaction bonus in the terms of the 2010 Letters. After the sale of the Hong Kong and Korea operations in 2010, a deal had been agreed for the sale of the Taiwan business in about June 2013 pending approval by the regulators.

30. Amidst Project G was still on foot pending the sale of Taiwan business, the Appellant entered into the 2011 Contract which remained effective until her termination of the employment. Among other things, the Appellant would be remunerated with salary and payments under the STI and LTI plans as well as the transaction bonus as mentioned in the 2010 Letters. At the time of the signing of the 2011 Contract, there was an expectation on the part of the Appellant that she would be relocating to City K for another role within the Employer's group of business. The Appellant's plan to relocate to City K came to a stop by the end of 2011 as she was informed by the Employer's group that her role in City K would be made redundant.

31. In or mid-2013, the Appellant was informed by the management of the Employer of their intention to terminate her employment. At the time, the Appellant was still hopeful that she could apply for an internal position within the group in City K. According to the Appellant, there was a lot of discussion during this period with the management. Whilst the management repeated the stance that they had been shutting down the business unit so that internal transfer to City K could not be done, the management assured the Appellant that if she decided to leave the employment, the Employment would pay her the better of the job elimination plan which the Appellant was otherwise not entitled to.

32. The Appellant complained about the lack of good faith on the part of the Employer in that the Employer should have known the group was closing down the business, yet the Employer made the promise to the Appellant that she could be relocated. The



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Appellant relied on the Employer's initial promise for her to have moved her furniture to City K and the Appellant commented that the short-lived expectation to relocate to US was 'personally traumatizing'. According to the Appellant, she was 'incredibly upset' and 'distressed' with the Employer's decision, and according to her, 'lack of good faith' on the part of the Employer.

33. It was under this context that there were a number of correspondence between the Appellant and the human resources department of the Employer in January 2014.

34. On 28 January 2014, after receiving the severance worksheet from the Employer, the Appellant sent an email to Ms P, human resource staff of the Employer, in the following terms:

*'Hi Ms P,*

*I have some specific questions re the worksheet. I raised some issues with Mr Q as my direct manager but I would like to explain my position.*

*I understand that what has been offered to me as a termination benefit is in line with the policy. However, given the unique circumstances of my very short lived and personally traumatizing relocation to the US, I request that consideration be given to the following issues.*

*1. Re the annual leave. I have accrued 41 days from carried forward from 2012 and 2013 based on specific approval by HR to do this. We were not in a position to take leave given the requirements of Project R and Project R1, and in fact even when I did take a few days leave, we were on calls. I would appreciate it if Company C could honor the agreement made to pay carry forward the leave.*

*2. Re health premiums, in all previous correspondence and severance quotes I was told I would have 6 months cover post termination. This is important for me as I look for another job. We were told that our termination arrangements would be the best of the Project G terms and the L 2012 policy. Project G offered 6 months insurance cover.*

*3. Re MPF. I have raised the issue of 10 year vesting period a number of times as I was not told about this punitive provision until 2 months after I began employment. I had also negotiated a 5% salary sacrifice at the time I started my job and I was not informed that this would be subject to a 10 year vesting. Furthermore, on agreeing to relocate to the US I believed that all pension funds were to be brought into line and have a common 5 year vesting period, as advised in the Executive Officers meeting at the end of 2011, and I understood the inequity were removed where different employees had very different vesting periods. As I have been employed for*

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*over 5 years, I would ask that an ex-gratia payment be made equal to the 50 % of benefit that I would lose with a 10 year vesting.*

*I am incredibly upset that after 5 years my pension savings amount to only 100,000 and this has had a significant impact of retirement planning*

*4. Given I have unexpectedly had to work another full year on this project, I would like to request your consideration of a 2013 LTI grant. When we were told there was not 2013 grant in 2012 I didn't raise concerns as I didn't know that the project R would fail and that we would have to stay on another year. I have made many personal and career sacrifices to close this project and such a significant reduction in expected compensation for the effort is disappointing.*

*5. Re the relocation benefit. I have no idea what the next steps are for me or what country I will find employment, accordingly I request that the relocation benefit be paid out as cash as part of the termination compensation. I believe this would equal around \$70,000*

*6. Regarding the STI payment. I am not sure what the performance uplift was for this year but I am surprised that it seems to be less than last year based on my STI amount. As we did not have any personal targets and the project was successfully completed, would we receive 100% of the performance uplift?*

*When I agreed to move to the US and continue to work with Company C I believed the statements made to me by management that could look forward to a great role which would enhance my career and that I would be well compensated. The requests I have made re the termination payment improvements are not unreasonable and are consistent with my financial expectations when I took the role. ·*

*I appreciate your review of my request and please let me know if you need any additional information.'*

35. When the Appellant was asked at the hearing that she did not raise any potential claims against the Employer in her email dated 28 January 2014, the Appellant said:

*‘Yes. It's not specifically raised there that I would sue them. I think that's quite aggressive. I had discussed it with them, saying that I was really disappointed they basically relocated me and then terminated the job. It's not written there, no. My very short lived and personally traumatizing relocation to the US. I have requested consideration of the following. I am incredibly upset. I have made many personal career sacrifices to close the project. This significant reduction is disappointing. I think the tone, the general tone of the communication is clear that I was distressed. But*

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*I was also very professional. I wasn't going to be making gross accusations in writing. I was trying to keep it civil. But I was very cross, and they knew it. As I said, I was sort of stranded between countries, and my furniture was in City K, I was kind of half in Hong Kong. I hadn't enacted my visa for the employments in the US. So it was very difficult, and they knew that. And to be fair, the HR department were sympathetic and helpful. So this certainly doesn't reflect accusations like that, but I wouldn't have done that in writing anyway.'*

36. The Appellant also acknowledged that she did not threaten the Employer with a claim of wrongful dismissal. In fact, from the evidence before the Board, no legal action of any sort had been threatened against the Employer by the Appellant.

37. The Appellant also explained that in relation to the request of uplift of LTI and STI grant, the Appellant felt that she had made a number of career and personal sacrifices for staying in employment and therefore the Employer should compensate her. The Appellant said the Employer rarely exercised the discretion to pay LTI and therefore the Appellant knew that she was not entitled to LTI. The Appellant used the LTI as a benchmark for what the compensation amount could be. The STI Payment was made according to the job elimination plan and according to the Appellant it was not performance related, although the Appellant also admitted that the Appellant requested for a STI Payment uplift because the project was successfully completed.

38. On 31 January 2014, Ms P on behalf of the Employer replied to the Appellant:

*'Hello Miss A,*

*1. For annual leave accrued but not taken from 2012 and 2013, we will pay out up to 50% of your total carry over days, not to exceed a total of 25 days. Therefore you will receive payment for an additional 16 days (41 total days\* 50% - 5) contingent upon you signing the release agreement. We have already processed payment for 5 carry over days from 2013 and Ms S sent an email regarding this under separate cover.*

*2. Although the agreement was that you would receive the better of the L2012 OR Project G severance program, we will grant the 3 additional months of medical coverage so that you will be covered for a total of 6 months post termination. Through Company T, you will be covered for the first 6 months and Company C will pay the cost. After the 6 months, you have the option to continue the coverage on a month by month basis for up to 12 months, where you cover the full cost. Additional information regarding Company T will be provided through our benefits department.*

*6. Your STI award includes an estimate of the company performance. As of right now, the company scorecard is coming in less than the maximum 175% multiplier.*

*With regards to your other requests (#3, 4, 5) below, we have taken them under consideration, however we are not able to grant them.*

*Please let me know if you have any additional questions.*

*Regards,  
Ms P'*

39. The Appellant explained by the email dated 31 January 2014 the Appellant was offered a severance that was equal to the better of what the Employer called L2012, which was the Job Elimination Plans, on an ex gratia basis as the Appellant had no right to such plan. The Appellant explained that the intention of the payment was to provide severance benefits to certain employees who have been involuntarily terminated because their jobs have been eliminated.

40. More importantly, the Appellant confirmed at the hearing that all the negotiations between her and the Employer were evidenced by the emails exchanged in end of January 2014, the material parts of these correspondence have been reproduced above.

41. As to the Form IR56Fs, the Appellant contended that they were completed based on the advice of the US based KPMG with no understanding of the purpose of the payment, limited understanding of the Hong Kong tax forms and their labeling were incorrect. The Appellant also criticized the statements given by KPMG as either incorrect, misleading or baseless.

### **Applicable legal principles**

42. Section 8(1) of the Inland Revenue Ordinance (**'the Ordinance'**) is the charging provision in respect of Salaries Tax which provides:

*'Salaries tax shall... 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 –*

*any office or employment of profit; ...'*

43. Section 9(1) of the Ordinance defines income as follows:

*'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...'*

44. Section 68(4) of the Ordinance places the burden of proof on the Appellant:

*‘The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.’*

45. The issue of whether a sum received by an employee upon termination should be chargeable to Salaries Tax was examined by the Court of Final Appeal in Fuchs v. Commissioner of Inland Revenue (2011) 14 HKCFAR 74. Mr. Justice Riberio PJ said:

*‘17. In my view, the same approach should be adopted in the construction of section 8(1) of the Ordinance. Income chargeable under that section is likewise not confined to income earned in the course of employment but embraces payments made (in Lord Radcliffe’s terms) “in return for acting as or being an employee”, or (in Lord Templeman’s terms) “as a reward for past services or as an inducement to enter into employment and provide future services”. If a payment, viewed as a matter of substance and not merely of form 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 abovementioned sense, it is assessable. This approach properly gives effect to the language of section 8(1).*

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

...

*22. In situations like those considered above, since the employment is brought to an end, it will often be plausible for an employee to assert that his employment rights have been “abrogated” and for him to attribute the payment received to such “abrogation”, arguing for an exemption from tax. It may sometimes not be easy to decide whether such a submission should be accepted. However, the operative test must always be the test identified above, reflecting the statutory language: In the light of the terms on which the taxpayer was employed and the circumstances of the termination, is the sum in substance “income from employment”? Was it paid in return for his acting as or being an employee? Was it an entitlement earned as a result of past services or an entitlement accorded to him as an inducement to enter into the employment? If the answer is “Yes”, the sum is taxable and it*

*matters not that it might linguistically be acceptable also to refer to it as “compensation for loss of office” or something similar. On the other hand, the amount is not taxable if on a proper analysis the answer is “No”. As the “abrogation” examples referred to above show, such a conclusion may be reached where the payment is not made pursuant to any entitlement under the employment contract but is made in consideration of the employee agreeing to surrender or forgo his pre-existing contractual rights. In the present appeal, the principal dispute between the taxpayer and the Revenue involves rival contentions along the aforesaid lines.’*

46. The principle in Fuchs v. Commissioner of Inland Revenue was also considered in another Court of Final Appeal decision Commissioner of Inland Revenue v. Poon Cho Ming, John (2019) 22 HKCFAR 344. Mr. Justice Bokhary NPJ said:

*‘14. As relevant to what we have to decide in the present case, what we held in Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 is as follows. Income chargeable to salaries tax under section 8(1) of the Ordinance is not confined to income earned in the course of employment. It includes payments made in return for acting as or being an employee. In other words, it includes rewards for past services. It also includes payments made by way of inducement to enter into employment and provide future services. 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 a taxpayer’s employment in the foregoing sense, it is chargeable to salaries tax. That analysis provides guidance on the operation of the relevant statutory words without supplanting or even modifying those words. Payments which are for something else do not come within the analysis, and are not chargeable to salaries tax. All of that appears at paragraphs 17 and 18 of the judgment which was given by Mr Justice Ribeiro PJ and agreed with by all the other members of the panel.’*

47. The applicable principles in Fuchs and Poon Cho Ming have been broadly summarised by Mr Justice Coleman in Heath Brian Zarin v. the Commissioner of Inland Revenue [2020] 2 HKLRD 229, as follows:

- (1) The question involves the construction of section 8(1)(a) of the Ordinance, namely whether payment is income ‘from’ any office or employment of profit.
- (2) 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.
- (3) Income chargeable under section 8(1) of the Ordinance 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’. 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. The vital question is what the ‘substance of the bargain’ is 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.

- (4) A payment that is concluded as being ‘for something else’ is not assessable, and does not come within the above test.
- (5) 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’.
- (6) 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.
- (7) 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)? 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.

48. Having considered Fuchs and Poon Cho Ming, if a payment is in substance (and not merely in form) is a reward for past services or a payment to induce the employee to enter into employment and provide future service, then it is chargeable to salaries tax and it matters not that it might linguistically be acceptable also to refer to it as ‘compensation for loss of office’ or something similar. If the payment is made for ‘something else’ such as if 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, then it is not chargeable to salaries tax.

49. Following the Fuchs test, a non-contractual payment could be chargeable to Salaries Tax under section 8(1)(a) of the Ordinance even though the employer was not obliged to pay it and thus the employee has no legal entitlement to it (see also Heath Brian Zarin). The operative test is whether the sum was paid in substance in return for acting as or being an employee. If the answer is yes, then it is chargeable to Salaries Tax.

50. In the circumstances, the nature of the each of the Relevant Sums will have to be examined closely in order to determine whether it was in substance a reward of past service. For instance, if a sum was in substance an income from employment, then regardless of whether it is labelled as something else, it is still chargeable to salaries tax. Further, though it is common that certain clauses such as ‘general release’, ‘confidentiality’ and other restrictive covenants are inserted in a termination agreement of an employment, it does not mean that the existence of those clauses would make a sum received upon termination of employment not chargeable to salaries tax. For instance:

- (1) In D24/14, the Board took the view that confidentiality and non-disparagement clauses were general terms and they did not impose any additional restriction on the taxpayer and were just basic obligations of any employee. Concerning the issue of abrogation of rights, the Board pointed out that the rights at stake cannot simply be those which the taxpayer may subjectively think that he had lost, but must be ascertained by the objective facts and circumstances including scrutinizing the terms of the employment contract; and
- (2) in D4/21, for an employment contract of the taxpayer which was not on fixed term and could be terminated by giving notice or payment-in-lieu by either party, and that the employer acted within its right to terminate the contract lawfully, notwithstanding there was a waiver and release of claims clause in the separation agreement, the taxpayer could not show that she had a *bona fide* cause of action against the employer and the employer was not aware of any potential claim. This Board took the view that since the taxpayer could not identify precisely what specific rights she had abrogated and that the sum was



paid to her for giving up that right, such release clause rendered no assistance to her case.

## Analysis

### The Release Ground

51. It cannot be in dispute that the Employment Contract was not a fixed term contract. Either the Employer or the Appellant may terminate the 2011 Contract with 3-month notice (or payment in lieu) (Clause 6). It follows that it cannot be disputed that the Employment Contract can be lawfully terminated, with 3-month termination notice given to the Appellant. The Appellant admitted this to be the case.

52. It is also not in serious dispute (at least it was not contended by the Appellant otherwise) that the Employer has provided sufficient notice to terminate the 2011 Contract. According to the Appellant's evidence, the Employer had informed the Appellant the intention to terminate her employment as early as mid-2013 which was more than the notice period.

53. It is pertinent to note that in the Appellant's own grounds of appeal, the Appellant admitted that no actions against the Employer were open to her:

*'While I am making no suggestion or accusation that any of these actions were open to me, I would have had the right to commence legal actions...'*  
(Emphasis added)

*'I agree with the Acting Deputy Commissioner that I lost no rights to the payments, but only because no rights existed.'*

54. More importantly, throughout the correspondence between the Appellant and the Employer in January 2014 (which the Appellant testified as being the only negotiations between them) and the contemporaneous communication with the IRD by the Appellant's letter dated 10 February 2015, the Appellant had not for once raised the point that she had a legitimate claim against the Employer whatsoever, regardless of whether it was for 'termination based on discrimination', 'constructive dismissal' or 'termination of employees that potentially breach internal HR policies and procedures'. Subsequently, the Appellant further corresponded with the IRD through her former tax representative, Best Frontier Limited, by letters dated 5 January 2018 and 21 June 2019. Neither of these letters from Best Frontier Limited raised any specific grounds as to any legitimate claim against the Employer (or the Parent Company).

55. Despite it was said by the Appellant that there were numerous oral exchanges with the Employer that were not documented that the payments were negotiated and paid as severance to keep her quiet, when being questioned by this Board as to the specific particulars of such oral exchange, the Appellant said:

*‘I don't think there's anything specific, Mr Chairman. It was mainly, as I said, there were a range of discussions. There were ongoing negotiations about what should be paid or what was fair. The job elimination programme and Project G. There was discussions around that. There's nothing specific that comes to mind that I think enhances what's already been said. Only just to say that the outcome of the payments that were made to me were a product of those discussions.’*

56. In fact, up to the hearing, the Appellant was unable to formulate any basis of a claim against the Employer (or the Parent Company) that the Appellant claimed to have foregone through the Separation Agreement.

57. Much has been said by the Appellant at the hearing about the breach of promise on the part of the Employer/ Parent Company of relocating the Appellant to City K prior to the entering of the 2011 Contract. However, during cross-examination, the Appellant acknowledged that under the 2011 Contract, the Employer may terminate the 2011 Contract by three-month notice, and that it was an express term in the 2011 Contract that it *‘does not create a contract of employment between [the Appellant] and [the Employer] for any specified period’*. When being asked that the Employer did not have the obligation to relocate the Appellant to City K, the Appellant admitted:

*‘There's never been a suggestion that [the Employer] were obligated to relocate me to City K.’*

58. The Appellant had also been informed of the Employer's decision as early as October 2011 that she was not being offered any position in City K. This Board agrees with the Commissioner that there is no evidence showing any correlation between the lapse of the City K relocation in October 2011 and the payment of the Relevant Sums. Whilst in the Appellant's email to the Employer dated 28 January 2014, the Appellant complained about her traumatizing experience in relation to the cancellation of her relocation to City K, there is no evidence that there were additional compensation in the Appellant's package at termination which were causative to these complaints. It is also not apparent that the Appellant's requests for additional compensation in her email dated 28 January 2014 were in any way causative of the lapse of the offer to relocate her to City K. In fact, in the Employer's reply dated 31 January 2014, the Employer expressly rejected at least 3 items of the Appellant's requests.

59. More importantly, none of the Appellant's complaint in the lapse of the relocation offer seems to give rise to a viable cause of action against the Employer. At the very least, the Appellant has not been able to formulate what cause of action she had in this regard and throughout October 2011 until January 2014, the Appellant has not demonstrated that she had substantiated a potential or actual claim against the Employer. In none of the evidence before this Board, the Appellant had demonstrated the quantum of her loss and damage.

60. The burden is on the Appellant to show that the Relevant Sums were ‘something else’ such as settlement sums of her actual or potential legitimate claims against

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the Employer. In order to show that any of the amount in the Relevant Sums constitute a settlement sum, the burden is on the Appellant to demonstrate that at least she had a legitimate claim against the Employer and the Employer was aware of such legitimate claim, before considering the question of whether such sum was paid to the Appellant causative to such claim.

61. Having considered the evidence of the Appellant, the contemporaneous correspondence as well as the concession made by the Appellant in her grounds of appeal and at the hearing, this Board is satisfied that the Appellant was unable to demonstrate that she had a legitimate claim against the Employer which the Employer was aware of, or any part of the Relevant Sums were intended to be paid to the Appellant as a settlement of such claims or for the abrogation of rights by the Appellant.

62. The Appellant also sought to argue that the Relevant Sums were paid to her for her to comply with the general release terms stated in the Separation Agreement, so that the Relevant Sums cannot be a reward of past services.

63. Having made the findings above that the Appellant has failed to show that she had a legitimate claim against the Employer known to the Employer, it is difficult for the Appellant to argue that the predominant intention of the payment of the Relevant Sums was for the Appellant to comply with the general release terms.

64. This Board agrees with the Commissioner that general release clause is common in a typical termination agreement so that the parties to the employment can achieve a clean break. The mere fact that these clauses exist in the Separation Agreement cannot by itself render a sum received upon termination of employment not chargeable to Salaries Tax. In fact, had this not been the case, any sums payable at termination of employment with a clean break clause would not then be chargeable to Salaries Tax, which cannot be right and is inconsistent with earlier decisions of the Board. Each case must be scrutinized by its own objective facts. At most, the general release clause is ancillary for the Employer to make the payment of the Relevant Sums as part of the package in the Separation Agreement, but not the effective cause of the payment itself.

65. In terms of the ‘confidentiality’ and ‘non-disparagement’ clauses, this Board agrees with the Commissioner’s submissions these are continuing obligations of an employee. At most, these clauses are ancillary for the Employer to make the payment of the Relevant Sums as part of the package in the Separation Agreement, but not the effective cause of the payment itself.

66. As to the Appellant’s reliance on the Poon Cho Ming case that the reason of the payment of the Relevant Sums was to stop the Appellant from ‘creating a fuss’, the Commissioner argued that Poon Cho Ming is clearly distinguishable on the fact. In Poon Cho Ming, the taxpayer was the Group Chief Financial Officer and an executive director of a listed company. He was informed of his immediate termination of employment and removal from office all in a sudden on a Friday afternoon and the termination was in an acrimonious manner. The taxpayer refused to go quietly. He issued serious legal threats against the employer: to start court proceedings and to challenge his removal at a general

meeting of the employer's shareholders. This would have attracted media interest and consequential market reaction. The sum was paid by the employer so that the taxpayer would *'drop his proposed two-pronged course of action, and to agree to present a united front with the employer (both internally and to the public) on the reasons for his departure'*. The Court concluded that the sum was the antithesis to a reward for his services.

67. By contrast, there was a substantial time lapse between the sale of the Hong Kong and Korea operations in October 2010, the lapse of the relocation offer in October 2011 and the ultimate Separation Agreement in 2014. In between these years, the Appellant had been paid substantial bonuses well exceeding her annual salary. There is no evidence whatsoever showing any animosity between the Employer and the Appellant. There is no evidence showing the Appellant had made any threats of any legal action or media exposures throughout. This Board agrees that the facts in Poon Cho Ming are clearly distinguishable.

68. From the Employer's perspective, the Relevant Sums were reported in the Form IR56Fs as 'Other Rewards, Allowances or Perquisites eg Bonus, Education Benefits, Shares' which are chargeable to Salaries Tax, a treatment which was also agreed by KPMG. Despite the Appellant sought to challenge these treatments on the basis that the Form IR56Fs were incorrectly completed based on direction of KPMG who had *'careless disregard for, and no understanding of the facts of the payment'*, it at the very least demonstrates that the Employer has all along treated the Relevant Sums as payments in return for the Appellant's service. In any event, for the reasons as provided above, the Appellant has also not advanced any convincing arguments that these treatments were incorrect.

69. The Release Ground therefore must fail.

#### ***The LTI and STI Payments Ground***

70. The Appellant claimed that the STI Payments and LTI Payments were non-contractual payments and she would only receive them on the condition that she remained an employee of the Employer. The Appellant further contended that the amount of the payments was well exceeded her entitled amount pursuant to the 2011 Contract.

71. The STI and LTI were part of the remuneration of the Appellant in her employment. They were provided in the 2008 Contract. They were also provided in the 2011 Contract. In fact, from the commencement of the Appellant's employment, bonus constituted a substantial part of the Appellant's remuneration which could well exceed her annual salary.

72. In respect of the Appellant's argument that STI and LTI Payments were not contractually payable once her employment has been terminated, each of the STI Plans and LTI Plans expressly provided for such entitlements despite termination of employment:

- (1) Section 1 of the STI Plan provided that the STI Plan supplemented the Employer's salary and benefit programs to *'reward certain employees who are active or have terminated employment with [the*

*Employer] who have achieved goals deemed by the Board as important to [the Employer]’ (emphasis added); and*

- (2) STI and LTI are expressly payable upon the exercise of discretion even if the participant has terminated the employment (see Section 4(d) of the STI Plan and Section 6(d) of the LTI Plan).

73. Hence, it is clear that the Appellant was eligible to participate in the STI and LTI Plans pursuant to the 2011 Contract and that the termination of her employment and her entitlements of STI and LTI Payments were not necessarily mutually exclusive. Thus, the Appellant’s claim that she must remain as an employee to receive STI and LTI Payments cannot be accepted.

74. In fact, in the email from the Appellant to the Employer dated 28 January 2014, the Appellant expressly enquired about the LTI and STI Payments by reasons of her performance during the services period. It is fair to read from the Appellant’s request that she herself also recognized the LTI and STI Payments were part of her remuneration package as services rendered in the past.

75. Insofar as the STI Payments were concerned, it was reflected by the Employer in a Personalized Statement rendered to the Appellant at termination of employment as incentive bonus for the Appellant’s performance in 2013. In the Appellant’s email dated 28 January 2014, the Appellant specifically sought clarification on whether the STI Payment would reflect ‘100% of the performance uplift’ for year 2013/14 as the amount ‘seems to be less than last year’. The Appellant specifically made reference to the fact that ‘the project was successfully completed’. In reply on 31 January 2014, the Employer clarified to the Appellant that the STI Payment included an estimate of the Employer’s performance. It is very clear that the STI Payment was made to the Appellant as an award for her past services with the Employer.

76. According to the Form IR56Fs, the LTI Payments consisted of:

- (1) Payment in lieu of 2013-2015 LTI: US\$50,000;
- (2) 2009-2011 LTI: US\$94,601;
- (3) 2011-2013 LTI: US\$300,000; and
- (4) 2012-2014 LTI: US\$208,334.

77. These sums have been expressly provided under the Separation Agreement as the value of the Appellant’s award under the LTI Plans during each of the performance periods, pro-rated to reflect the actual time that she was employed during each performance period. Hence for the performance period from 2009 to 2013, the LTI Payments were clearly paid to the Appellant for the Appellant’s past services. For the performance periods of 2012-2014 and 2013-2015, they were expressly provided to be payable pro rata to reflect the actual time the Appellant was employed, and for the same reason they were paid to the

Appellant for the Appellant's past services.

78. Although it is arguable that apart from the 2009-2011 LTI, the rest of the LTI might yet have been vested to the Appellant as of January 2014 had the employment not having been terminated, the LTI Plan expressly provides that these payments shall become 100% vested (but subject to apportionment for the pro rata period the Appellant actually performed services) upon discretion and upon the participant having executed a waiver and release to the Employer.

79. The Appellant has not provided other evidence that the LTI and STI Payments well exceeded her entitlements under the 2011 Contract other than suggesting that these payments were not payable upon termination of employment. This Board has already dealt with this argument above.

80. Further, as Fuchs explained above, a non-contractual payment (such as ex gratia payment) is chargeable to Salaries Tax if the substance of the payment was paid in return for acting as or being an employee. Hence, even if, as contended by the Appellant, that the LTI and STI Payments were non-contractual, it does not necessarily mean they are not chargeable to Salaries Tax. These LTI and STI Payments were clearly paid to the Appellant remunerating her past services, regardless of whether they have been contractually vested. Accordingly, these payments must be chargeable to Salaries Tax.

81. The LTI and STI Payments Ground therefore must also fail.

### ***The Other Payments Ground***

#### **'Deal Bonus'**

82. It was explained by KPGM that the 'Deal Bonus' was in general paid to an employee for her to stay with the company for a certain period to complete a deal of the company. The Appellant claimed that she was never being told why it was paid and she assumed it was related to a deal, yet she accepted in her testimony that both the Employer and the Appellant confirmed that the 'Deal Bonus' was paid for the service the Appellant rendered for the sale of business. In fact, it was admitted by the Appellant in her letter dated 6 September 2022 that the 'Deal Bonus' was *'expressed to be a 'thank you' for selling the Taiwan business'* and was an *'ex-gratia payment'* but not *'linked to any contractual right'*.

83. As Fuchs explained above, a non-contractual payment (such as ex gratia payment) is chargeable to Salaries Tax if the substance of the payment was paid in return for acting as or being an employee. The 'Deal Bonus' is clearly a reward to the Appellant for her past service, specifically in closing the Taiwan Deal, and therefore must be chargeable to Salaries Tax.

#### **'Payment Enhancement'**

84. The Appellant contended that *'As clearly stated in the Job Elimination Plan*

*2012; the Personalized Illustration of the severance benefits and under [Separation Agreement], [Payment Enhancement], like [Enhanced Severance Benefit] and [Special Leader Severance Benefit] were paid as part of the severance payment...Further, it is inconsistent and incorrect to say [Enhanced Severance Benefit] and [Special Leader Severance Benefit] can be accepted as a not taxable and not apply the same treatment to [Payment Enhancement].’.*

85. As explained by KPMG, the ‘Payment Enhancement’ was the Employer’s practice, but not a policy, that for executive member if the severance payment computed under the Job Elimination Plans was less than 52 weeks’ pay, a discretionary payment would be made to the employee to ensure he/she received a minimum of 52 weeks’ pay.

86. Whilst the ‘Enhanced Severance Benefit’ and ‘Special Leader Severance Benefit’ were set out in the Job Elimination Plans with prescribed formula, the ‘Payment Enhancement’ was not been included in the Job Elimination Plans. The ‘Enhanced Severance Benefit’ set out in the Job Elimination Plans would be up to a **maximum** of 52 weeks’ pay. The ‘Payment Enhancement’ would be made up to ensure there be a **minimum** 52 weeks’ pay.

87. Whilst the ‘Enhanced Severance Benefit’ and ‘Special Leader Severance Benefit’ were not reported by the Employer in the Form IR56Fs as taxable income, the ‘Payment Enhancement’ was included in the Form IR56F as ‘Other Reward and Allowances’ subject to Salaries Tax.

88. It is therefore apparent that the nature of the ‘Payment Enhancement’ is different from ‘Enhanced Severance Benefit’ and ‘Special Leader Severance Benefit’. Whilst the IRD did not assess the latter to be subject to Salaries Tax, ‘Payment Enhancement’ cannot be taken to be treated as the same way.

89. According to Fuchs, income chargeable to Salaries Tax is not confined to income earned in the course of employment. In D12/11, the taxpayer was not entitled to an ex-gratia payment pursuant to the employment agreement, but this did not prevent the Board from concluding that the gratuity paid upon his termination was paid in return for acting as an employee. Also, it is important to point out that in determining whether a sum falls within the test stated by Ribeiro PJ in the Fuchs case, it is crucial to ascertain the purpose of the sum and should not be distracted by its label. 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, it is assessable.

90. The ‘Payment Enhancement’ is very similar to a gratuity paid upon termination of employment and therefore can be chargeable to Salaries Tax. Based on available evidence, the Appellant has also not discharged the burden to show that the ‘Payment Enhancement’ was paid other than for her acting as or being an employee or for services rendered.

**‘Consulting Fee and Expenses’**

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91. The Appellant in her grounds of appeal claimed that the ‘Consulting Fee and Expenses’ was the consulting fee paid for obtaining legal advice. In the Appellant’s letter to the IRD dated 6 September 2022, the Appellant reiterated that the sum was ‘*an estimate of professional fees and an unexpected ex-gratia addition to the severance and is not related to any services provided*’.

92. In contrast, the ‘Consulting Fee and Expenses’ was reported by the Employer under ‘other rewards’ of the Form IR56Fs chargeable to Salaries Tax. In the Employer’s payroll advice for the Appellant, the sum was broken down to US\$60,000 for ‘Consulting Fee’ and US\$15,000 for ‘Consulting Expenses’. KPMG described this sum should be paid to the Appellant ‘*to assist in an ad hoc capacity after her redundancy with transitional issues as the Employer’s Hong Kong operations wound down*’. The Appellant believed this sum should be an estimation by the Employer based on their own experience in the US in relation to how much it would cost.

93. The Appellant was specifically asked at the hearing whether there were any documents showing that the ‘Consulting Fee and Expenses’ was an estimated professional fee. The Appellant said:

*‘No, I don’t have anything. The only information I’ve got was when they presented it in the separation agreement, it was called ‘consulting fees’. And I’m not sure what that was related to.’*

94. The Appellant also confirmed in her testimony that she had not incurred any professional fees and expenses, nor did she provide any invoices or receipts to the Employer in relation to any professional fees and expenses incurred.

95. Hence it is clear that the sum was not a fee paid to the Appellant ‘for obtaining legal advice’ as she claimed. The Appellant had not even incurred any fees in such regard.

96. The ‘Consulting Fee and Expenses’ is very similar to a gratuity paid upon termination of employment and therefore can be chargeable to Salaries Tax. Based on available evidence, the Appellant has also not discharged the burden to show that the ‘Consulting Fee and Expenses’ was paid other than for her acting as or being an employee or for services rendered.

97. The Other Payments Ground therefore must also fail.

## **Conclusion**

98. For the aforesaid reasons, the Appellant’s appeal is dismissed.