

**Case No. D22/22**

**Salaries tax** – awards under incentive plans – accrual of payment – whether payment made to employee pursuant to incentive plan chargeable at grant of awards or vesting of awards – sections 8, 9, 11B, 11D and 64 of the Inland Revenue Ordinance (‘IRO’)

Panel: Hau Pak Sun (chairman), Fung Chih Shing Firmus and Poon Nga In.

Date of hearing: 19 January 2021.

Date of decision: 7 December 2022.

The Appellant was first employed by a Hong Kong company, but from 2009 to 2015 was assigned to work in another city. Successive employment contracts stated that the Appellant’s employment started from the first day he was ever employed. The employer maintained incentive plans, under which award units might be granted to employees. The award units would become vested in 1 or 3 years after the grant, with payment to be made to the employees as cash in the following year. The employer confirmed that the value of the award units could only be determined after they vested, as the formula depended on the ascertainment of the earnings of the employer.

On divers dates between 2012 and 2017, the Appellant was awarded award units under the incentive plans, on top of his salaries and allowances. The employer paid him HK\$5 million as encashment of the award units in the 2015/16 to 2017/18 years of assessment. The Deputy Commissioner determined that the payments for the award units accrued to the Appellant at the time when he was paid. The Appellant appealed against the Determination of the Deputy Commissioner, contending that they were accrued at the time when the award units were initially granted to him, during which he was stationed outside Hong Kong. As a result, those payments should not be charged with salaries tax.

**Held:**

- (1) Assessable income under section 8 of the IRO embraces payments made as a reward for past services or as an inducement for future services (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 applied). The award units granted to the Appellant under the incentive plans were fundamentally different from shares or stock options, as the value could only be determined after the expiry of the vesting period, and they could not be transferred before receiving payment. The Appellant could only obtain pecuniary advantage of the award units at the time when payments were made to him. The award units did not fall under section 9(1)(d) of the IRO. Instead, income accrued to him during the year of assessment he received those payments as per section 11D(a) of the IRO (Heaton v Bell

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

[1970] AC 728; Weight v Salmon (1935) 19 TC 174 considered; Ede v Wilson and Cornwell (1945) 26 TC 381; Abbott v Philbin [1961] AC 352 distinguished)

- (2) The award units were not granted in relation to the period when the Appellant worked outside Hong Kong. The payments were calculated based on the employer's earnings but not the individual performance of the Appellant. The incentive plans expressly stated that payments were conditional upon the Appellant staying in employment during the vesting period, so the award units were granted for future performance.
- (3) The payments from the award units were not made on the Appellant's retirement or termination of employment; nor were they lump sum payments for deferred pay or arrears of pay. Therefore, section 11D(b)(i) could not assist the Appellant.
- (4) Materials from overseas tax authorities were unhelpful as no reasonable analogy could be drawn (Tadjudin Sunny v Bank of America, National Association [2016] HKCA 201; CIR v Poon Cho-ming, John [2019] HKCFA 28 considered irrelevant). Similarly, accounting standards that may be applicable to an employer do not assist the interpretation of the IRO, as they served purposes different from the IRO (D26/07 (2007-08) 22 IRBRD 601; D46/05 (2005-6) 20 IRBRD 110; Nice Cheer Investment Limited v CIR (2013) 16 HKCFAR 813 followed).
- (5) (*obiter*) In any event, the Appellant's employment remained sourced in Hong Kong since he was first employed by his employer, as there was continuity of his employment since then. Once income was derived from an employment in Hong Kong, there was no provision for apportionment under section 8(1) of the IRO based on the place where the services were rendered (Commissioner of Inland Revenue v Goepfert [1987] 2 HKTC 210 followed). Secondment of employment did not necessarily change the location of employment. The Appellant did not produce any evidence to substantiate such a change of location (Lee Hung Kwong v Commissioner of Inland Revenue [2005] 4 HKLRD 80 applied).

**Appeal dismissed.**

Cases referred to:

Fuchs v Commissioner of Inland Reveune (2011)14 HKCFAR 74  
Heaton v Bell [1970] AC 728  
Weight v Salmon (1935) 19 TC 174  
Ede v Wilson and Cornwell (1945) 26 TC 381  
Abbott v Philbin [1961] AC 352  
Tadjudin Sunny v Bank of America, National Association [2016] HKCA 201

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

Commissioner of Inland Revenue v Poon Cho-ming, John [2019] HKCFA 28  
D26/07, (2007-08) IRBRD, vol 22, 601  
D46/05, (2005-06) IRBRD, vol 20, 616  
Nice Cheer Investment Limited v CIR (2013) 16 HKCFAR 813  
Commissioner of Inland Revenue v Goepfert [1987] 2 HKTC 210  
Lee Hung Kwong v Commissioner of Inland Revenue [2005] 4 HKLRD 80

Chan Kam Wing William, CPA, for the Appellant.

Ho Chi Ho, Fung Chi Keung and Leung Ching Yee, for the Commissioner of Inland Revenue.

**Decision:**

1. Mr A (**‘the Appellant’**), a Hong Kong resident, was employed by the Group B (**‘the Group’**) as a Position C since 30 July 2007. The Group engages in the business of credit ratings, commentary and research services.

2. The Appellant’s relevant history of employment with the Group can be summarized as follows:

- (1) The Appellant was first employed in Hong Kong by Company D, a company of the Group and incorporated in Hong Kong, as a Position E in Sales and Marketing, with the commencement date of employment on 30 July 2007 (**‘Commencement Date’**). At all relevant time, Company D’s principal place of business was also in Hong Kong.
- (2) From May 2008 onwards, the Appellant was employed by Company F, also a company of the Group, as a Position E in specialist product sales. It was an express term of his employment with Company F that there shall be continuity of employment of the Appellant by Company D from the Commencement Date;
- (3) From 1 June 2009 to 31 August 2015, the Appellant was assigned by Company D to work in City G as a Position E. It was also an express term of the assignment that there shall be continuity of employment of the Appellant by Company D from the Commencement Date. Despite the Appellant was assigned from Hong Kong to City G, the relevant employment letters (respectively dated 25 February 2009 and 11 May 2012) stated that the Appellant’s employment was with Company D; and
- (4) From 1 September 2015 to 31 August 2018, the Appellant was relocated to Hong Kong and employed by Company D as Position H.

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

3. The Group operated two Long-Term Incentive Compensation Plans with effect from 1 February 2009 (**‘the 2009 LTIP’**) and 1 January 2015 (**‘the 2015 LTIP’**) respectively. Awards in the forms of Performance Units, Performance Shares (**‘the Awards’**) and Restricted Stock Units (**‘RSUs’**) were granted annually to employees holding key leadership positions of the Group. In general, once the Awards/ RSUs have been granted, there will be a relevant period of 1 year (for RSUs) or 3 years (for the Awards) for the Awards and RSUs to become vested, with payment to be made to the employee in the following year.

4. The Appellant was a participant in both the 2009 LTIP and the 2015 LTIP by virtue of his employment as a Position C in the Group. Pursuant to the two LTIPs, the Appellant has received the payments from the two LTIPs during the following year of assessment:

<u>Year of Assessment</u>	<u>Amount (HK\$)</u>
2015/16	926,143
2016/17	1,710,054
2017/18	3,033,688

(**‘the LTIP Payments’**)

5. The core issue of this appeal is whether the LTIP Payments were accrued to the Appellant at the time when he was paid these sums during the relevant years of assessment (as determined by the Deputy Commissioner of Inland Revenue (**‘the Commissioner’**)), or whether the LTIP Payments were, as the Appellant contends, accrued at the time when the Awards and RSUs were initially granted/ awarded or during the relevant period before the payments were made.

**Terms of the LTIPs**

6. The relevant terms of the 2009 LTIP are as follows:

(1) Section 1 – *‘Purpose – The purpose of Group B Long-Term Incentive Compensation Plan (the ‘Plan’) is to further the long-term growth and profitability of Company J, Company K and Company L (collectively doing business as ‘Group B’), their subsidiaries and other consolidated entities (collectively, ‘the Corporation’) by offering additional incentive to those officers and key employees of the Corporation who have a significant impact on the Corporation’s growth and profitability, to assist the Corporation in retaining highly competent management and to attract additional persons of outstanding competence to serve as officers and key employees of the Corporation.’*

(2) Section 2 – Definitions

*‘Base Period’ shall mean the three fiscal years immediately prior to (but excluding) the fiscal year of grant of Performance Units.*

*‘Earnings Period’ shall mean the three-year fiscal period consisting of the fiscal year of grant and the two subsequent fiscal years.*

*‘Grant Value’ shall mean [US\$]100.*

*‘Terminal Value’ shall mean the amount determined by (x) multiplying the Grant Value by the fraction having as its numerator the average Adjusted EBITA for the Earnings Period and as its denominator the average Adjusted EBITA for the Base Period and (y) subtracting from the amount so determined the Grant Value.*

- (3) Section 4 – *‘Eligibility for Participation in the Plan: Participation in the Plan shall be limited to full-time officers and key employees of the Corporation who, in the judgment of the [Incentive Compensation Plan Committee (**‘the Committee’**)], occupy positions which enable them to make significant contributions to the long-term performance, growth and profitability of the Corporation.’*
- (4) Section 5 – *‘Grants of Performance Units and Awards Thereof: ... The Committee shall, in its sole discretion, determine the number of Performance Units to be granted to a participant. Subject to the discretion of the Committee, Performance Units shall be awarded annually during the term of the Plan.’*
- (5) Section 6 – *‘Payment of Performance Unit Awards: Subject to the conditions stated in Section 7 hereof, the Terminal Value payable with respect to each Performance Unit for any Earnings Period shall be payable and paid, without any action of the grantee, as soon as practicable after the later of (i) the beginning of the next calendar year after the end of such Earning Periods and (ii) the date on which the calculation of the amount payable shall become available (but in no case later than the end of such next calendar year).’*
- (6) Section 7 – *‘Special Provisions and Conditions Related to Payment of Performance Unit Awards:*
  - (b): *‘Except in the limited circumstances hereinafter specified, payment of each Performance Unit award is conditional upon the continued employment of a participant with the Corporation through the relevant Earning Period. Accordingly, if employment should terminate prior to the end of an Earnings Period, the right to receive payment of a Performance Unit award relating to such Earnings Period shall terminate and no payment shall be made with respect to such award.’*

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (7) Section 7(c) sets out the circumstances which Performance Unit award is payable notwithstanding termination/ suspension of employment prior to the end of an Earnings Period: total and permanent disability, retirement, military or other leave of absence approved by the Corporation and death. Section 7(g) further requires that under these circumstances (other than death), the Committee may impose upon such participants reasonable conditions such as non-competition.
- (8) Section 8 – *‘Nontransferability: Except as otherwise provided in Section 7 hereof in respect of a designated beneficiary, no Performance Unit award or the right to receive payment thereof may be transferred, assigned, pledged, encumbered or otherwise disposed of, voluntarily or involuntarily; any attempts to transfer, assign, pledge, encumber or otherwise dispose of a Performance Unit award or the right to receive payment thereof shall be void and unenforceable.’*

7. The relevant terms of the 2015 LTIP are as follows:

- (1) Section 1 – *‘Purpose – The purpose of the Company M Long-Term Incentive Compensation Plan effective January 1, 2015 (the ‘Plan’) is to further the long-term growth and profitability of Company M and its subsidiaries (each, a ‘Subsidiary’ and together with Company M, collectively, ‘the Corporation’) by offering additional incentive to those officers and key employees of the Corporation who have a significant impact on the Corporation’s growth and profitability, to assist the Corporation in retaining highly competent management and to attract additional persons of outstanding competence to serve as officers and key employees of the Corporation.’*
- (2) Section 2 defines ‘Share Grants’ collectively to mean Performance Shares and RSUs;
- (3) Section 3 - *‘Eligibility for Participation in the Plan: Participation in the Plan shall be limited to full-time officers and key employees of the Corporation who, in the judgment of the Committee, occupy positions which enable them to make significant and extraordinary contributions to the long-term performance, growth and profitability of the Corporation.’*
- (4) Section 4 – *‘Share Grants and Awards Thereof: Awards under this Plan shall be granted to participants, according to their organizational level and operational responsibilities in the form of Performance Shares and RSUs. At the time of a Share Grant award, each Performance Share shall be valued at the notional value of [US]\$100 (‘the Performance Share Grant Value’) and each RSU at*

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

*[US]\$10.00 (the 'RSU Grant Value'). The Committee shall determine the total number of Performance Shares and RSUs to be awarded each year... Share Grants shall be awarded annually during the term of the Plan with an Effective Date of January 1 of the year awarded.'*

(5) Section 5 – 'Valuation of Performance Shares:

(a) *The value per share of a Performance Share shall be equal to the difference between the Ending Value and the Performance Share Grant Value ('the Performance Share Value'), provided that in no event shall the Performance Share Value exceed [US]\$75.00 ('the Performance Share Capped Amount') in any Performance Share Payment Year. The Performance Share Payment Year shall be the third year immediately following the year of the award.*

*Performance Share Ending Value: The Ending Value in the case of Business Unit, Group or Corporate Performance Shares shall be equal to the amount, expressed in US Dollars, calculated by (x) dividing the Pre-tax income of the Business Unit, Group or Company M, as applicable, in the year immediately prior to the Performance Share Payment Year by the Pre-tax income of the Business Unit, Group or Company M, as applicable in the year immediately prior to the Effective Date of the Share Grant award, and (y) multiplying that ratio by the Performance Share Grant Value.'*

(b) *Valuation of RSUs: The value per share of an RSU ('the RSU Value') shall be equal to the amount, expressed in USD, calculated by (x) dividing the Pre-tax income of the Corporation at the end of the vesting period by the Pre-tax income of the Corporation in the year immediately prior to the Effective Date of the RSU Share Grant award and (y) multiplying that ratio by the RSU Grant Value, provided that in no event shall the RSU Value exceed [US]\$17.50 ('the RSU Capped Amount') in any RSU Payment Year. The RSU Payment Year shall be the year after the relevant RSUs have vested.*

(c) ...

(d) Vesting and Payment of Performance Shares and RSUs.

(i) *Subject to the conditions stated in Section 6 hereof, Performance Shares shall vest at the end of the third year following a Share Grant of Performance Shares and the*

*total amount payable with respect to Performance Shares shall be paid, in cash, to each participant as soon after its determination as may be practicable in the Performance Share Payment Year. The total Performance Share payment to a participant shall be equal to the number of Performance Shares vested multiplied by the respective Performance Share Value or Performance Share Capped Amount (as applicable) per share.*

- (ii) *Subject to the conditions stated in Section 6 hereof, awards of RSUs shall vest in one-third increments at the end of each of the three years beginning in the year of a Share Grant of RSUs, and the total amount payable with respect to RSUs shall be paid, in cash, to each participant as soon after its determination as may be practicable in the RSU Payment Year. The total RSU payment to a participant shall be equal to the number of RSUs vested multiplied by the respective RSU Value or RSU Capped Amount (as applicable) per share.*
- (6) Section 6: *‘Conditions for Payment of Share Grants: (a) Except in the limited circumstances hereinafter specified, payment of each Share Grant award is conditioned upon the continued employment of a participant with the Corporation through the vesting period for the respective Performance Shares and RSUs (‘the Award Period’); if employment should terminate prior to the end of an Award Period the right to receive payment of a Share Grant award relating to such Award Period shall terminate and such payment shall not be made.’*
- (7) Section 6 sets out the circumstances which Share Grant award is payable notwithstanding termination/ suspension of employment prior to the end of an Award Period: total and permanent disability, retirement, military or other leave of absence approved by the Corporation and death, as well as termination of employment on grounds other than for cause or by mutual agreement. Similar to the 2009 LTIP, the 2015 LTIP provides that under these circumstances (other than death), the Committee may impose upon such participants reasonable conditions such as non-competition (Section 6(e)). In the case of termination of employment by mutual agreement, the Committee has the discretion to decide whether any part of the Share Grant award shall be paid.
- (8) Section 7 – *‘Nontransferability: Except as otherwise provided in Section 6 hereof in respect of a designated beneficiary, no Share Grant award or the right to receive payment thereof may be transferred, assigned, pledged, encumbered or otherwise disposed of,*



*voluntarily or involuntarily; any attempts to transfer, assign, pledge, encumber or otherwise dispose of a Share Grant award or the right to receive payment thereof shall be void and unenforceable.'*

8. Apart from the LTIP Payments, during the relevant years of assessment the Appellant was contractually entitled to and was paid salaries, bonus and other allowances and benefits which were reported in the relevant salaries tax returns as separate items from LTIP Payments. Bonus payments, in particular, were paid at the absolute discretion of Company D taking into account performance and profitability of Company D, the Company D's business area and the employee's own contribution, and that bonus payments are made conditional upon the employee remains as an employee and not under notice on the date the bonus payment is made without any entitlement to bonus accrued pro rata. It is clear that the bonus scheme operates separately from the two LTIP schemes.

### **LTIP Payments paid to the Appellant relevant to this Appeal**

9. Of relevance to this appeal, the Appellant was granted the following Awards and RSUs under the 2009 LTIP and 2015 LTIP, and the LTIP Payments resulting from these Awards/ RSUs paid to the Appellant during the years of assessment 2015/16 to 2017/18 are as follows, which were reported by Company D in Employer's Return in respect of the Appellant's income.

#### **(1) Year of assessment 2015/16**

A net sum of HK\$926,143 was paid to the Appellant in April 2015 from LTIP awarded on 1 January 2012 (in the form of Performance Units under the 2009 LTIP), with vesting date on 31 December 2014.

#### **(2) Year of assessment 2016/17**

(a) HK\$1,556,372 was paid to the Appellant in April 2016 from LTIP awarded on 1 January 2013 (in the form of Performance Units under the 2009 LTIP), with vesting date on 31 December 2015.

(b) HK\$153,682 was paid to the Appellant in April 2016 from LTIP awarded on 1 January 2015 (in the form of RSUs under the 2015 LTIP), with vesting date on 31 December 2015.

#### **(3) Year of assessment 2017/18**

(a) A total of HK\$1,344,919 was paid to the Appellant in April 2017 from:

a. LTIP awarded on 1 April 2014 (in the form of Performance Units under the 2009 LTIP), with vesting date on 31 December 2016;

- b. LTIP awarded on 1 January 2015 (in the form of RSUs under the 2015 LTIP), with vesting date on 31 December 2016; and
  - c. LTIP awarded on 1 January 2016 (in the form of RSUs under the 2015 LTIP), with vesting date on 31 December 2016.
- (b) A total of HK\$1,688,769 was paid to the Appellant in March 2018 from:
- a. LTIP awarded on 1 January 2015 (in the form of Performance Shares under the 2015 LTIP), with vesting date on 31 December 2017;
  - b. LTIP awarded on 1 January 2015 (in the form of RSUs under the 2015 LTIP), with vesting date on 31 December 2017;
  - c. LTIP awarded on 1 January 2016 (in the form of RSUs under the 2015 LTIP), with vesting date on 31 December 2017; and
  - d. LTIP awarded on 1 January 2017 (in the form of RSUs under the 2015 LTIP), with vesting date on 31 December 2017.

### **The Commissioner's determination and the Appellant's grounds of appeal**

10. These incomes were all assessed by the Commissioner as income chargeable for the Appellant's Salaries Tax for the years of assessment 2015/16 to 2017/18. The Commissioner took the view that the LTIP Payments were paid to the Appellant during the years of assessment 2015/16 to 2017/18 in which the Appellant was employed by Company D, a company which was incorporated and carrying on business in Hong Kong. As the Appellant was under a Hong Kong employment at the time of payment, the LTIP Payments resulted directly from the Appellant's employment with Company D in Hong Kong.

11. The Appellant objected to the assessment and claimed that part of the LTIP Payments were related to the period before the Appellant was relocated to Hong Kong and should not be chargeable to salaries tax for the years of assessment 2015/16 to 2017/18. The Appellant claims that these sums should be assessed in the years of assessment 2008/09 to 2014/15 when the Appellant was assigned to Country N/ under secondment to City G and rendered all his services outside Hong Kong. The Appellant's Grounds of Appeal can in principle be summarized into the following grounds:

- (1) It is incorrect to regard the LTIP Payments as being accrued to the Appellant on the date of payment during the years of assessment 2015/16 to 2017/18. This deviates from the accrual basis as provided in Section 11B and 11D(a) of the Inland Revenue Ordinance (**‘the Ordinance’**);
- (2) Part of the LTIP Payments were in relation to the period when the Appellant rendered all services outside Hong Kong during the years of assessment 2008/09 to 2014/15 which the Appellant was exempted from Salaries Tax pursuant to section 8(1B) of the Ordinance, having visited in Hong Kong for less than 60 days for each of the relevant years of assessment; and
- (3) The 2009 LTIP and 2015 LTIP imposed performance conditions, ie the terminal value of the Awards and RSUs depended on the growth of the pre-tax income of the Group. Therefore those LTIPs should be regarded as ‘for’ the whole performance or reference period.

12. There is no dispute in this appeal that if the LTIP Payments were indeed accrued during the years of assessment 2015/16 to 2017/18, they are income of the Appellant chargeable to Salaries Tax for each of the relevant years.

13. The Appellant has neither testified nor called any witness to support his case.

14. Section 68(4) of the Ordinance provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.

### **Relevant legislative provisions and legal principles**

15. The relevant sections of the Ordinance provide as follows:

#### ***‘8. Charge of salaries tax***

*(1) Salaries tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from the following sources*

–

*(a) any office or employment of profit ...*

#### ***9. Definition of income from employment***

*(1) Income from any office or employment includes –*

*(a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from*

*the employer or others, ...*

...

**11B. Ascertainment of assessable income**

*The assessable income of a person in any year of assessment shall be the aggregate amount of income accruing to him from all sources in that year of assessment.*

...

**11D. Receipt of income**

*For the purpose of section 11B –*

*(a) income which has accrued to a person during the basis period for a year of assessment but which has not been received by him in such basis period shall not be included in his assessable income for that year of assessment until such time as he shall have received such income, when notwithstanding anything contained in this Ordinance, an additional assessment shall be raised in respect of such income:*

*Provided that for the purposes of this paragraph income which has either been made available to the person to whom it has accrued or has been dealt with on his behalf or according to his directions shall be deemed to have been received by such person;*

*(b) income accrues to a person when he becomes entitled to claim payment thereof ...”*

16. Reading together sections 8(1)(a) and 11B of the Ordinance, for salaries tax to be chargeable, there must be (i) income, (ii) accruing in the year of assessment, (iii) from Hong Kong, and (iv) from any office or employment of profit.

17. Assessable income is, however, 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 (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 at paragraph 17).

18. Section 9(1)(a) of the Ordinance defines income from any office or employment widely as including ‘*any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others*’.

19. Insofar as ‘perquisite’ in Section 9(1)(a) of the Ordinance is concerned:
- (1) It is confined to actual money payments and to benefits in kind capable of being turned to money or which can be turned to pecuniary account or payments convertible to money or that which could be converted into money (Heaton v Bell [1970] AC 728);
  - (2) Thus, the grant of shares in companies can undisputably be ‘perquisites’ when given to an employee and therefore form part of his income. The grant of other rights relating to shares may also amount to ‘perquisites’. For instance:
    - a. privilege to apply for shares in a company at par value which was lower than their market value, when conferred, was of money’s worth and capable of being turned to pecuniary account was held to be assessable to income tax (Weight v Salmon (1935) 19 TC 174);
    - b. This is so even if the privilege to subscribe for such shares comes with an undertaking not to sell the shares without the permission of the company’s directors, as the shares in substance can be turned into money because the shares can still be sold (notwithstanding the undertaking not to sell) with or without the consent of the directors (Ede v Wilson and Cornwell (1945) 26 TC 381);
    - c. Likewise, it was held in Abbott v Philbin [1961] AC 352 that the grant of non-transferrable option for an employee to subscribe for shares was a right that could be turned to pecuniary account. The House of Lords considered that as the worth of the option exceeds its option price, it is freely convertible into money as the employee may at any time sell or raise money on the option, even though he could not put any one he dealt with into his own position as option holder against the company.
  - (3) In Abbott v Philbin, it was further held that the advantage which arose by the exercise of the option two years after it was granted (when the share price became substantially higher than the option price) was not a perquisite or profit from the office when it was exercised, as it was an advantage which accrued to the employee as the holder of a legal right which he had obtained in an earlier year. It was said by the House of Lords that the quantum of the benefit is the profit of his exploitation of a valuable right instead of the profit of the service<sup>1</sup>.

---

<sup>1</sup> The position in Hong Kong has since changed by the addition of sections 9(1)(d) and 9(4) from the Inland Revenue (Amendment) Ordinance 1971.

### **The issues for this appeal**

20. The essential questions before this Board are therefore:
- (1) Whether the grants of the Awards/ RSUs under the two LTIPs constitute income (which includes perquisites) received by the Appellant at the time when he received the payments from such grants or during the vesting periods or at the time of grant, so that income has accrued to him during the years of assessment within the meaning of section 11D(a) of the Ordinance when he received the income for the purpose of section 11B of the Ordinance; and
  - (2) When was the Appellant entitled to claim payment in relation to the Awards/ RSUs, so that income has accrued to him during the year of assessment when he was entitled to claim payment within the meaning of section 11D(b) of the Ordinance, for the purpose of section 11B of the Ordinance.

### **Analysis**

21. To answer the two essential questions, it is important to examine the substance of the two LTIPs by reference to their respective terms. In doing so, the Board also bears in mind that the question has to be approached as a matter of substance and not merely of form, and without being ‘blinded by some formulae which the parties may have used’ (Fuchs, at paragraph 17).

22. To start with, by a letter dated 30 July 2020, Company D wrote to the Commissioner to explain the nature of the two LTIPs in the following terms:

*‘Group B has operated LTIP since 2009, which is essentially a deferred cash bonus compensation provided to the senior management members of Group B and its subsidiaries across the global including [Company D]. LTIP is not a share-based or stock-based compensation as the compensation under LTIP is neither in the form of grant or issuance of any equity shares, stocks or units of Group B or its subsidiaries or any rights to such shares, stocks, or units nor is the compensation based on the value or changes in the value of such equity shares, stocks or units. Final cash payment amounts of LTIP is determined and computed under pre-determined rules stipulated in the LTIP plan documents and is largely linked to the achieved growth of the Group B’s consolidated earnings during a given period – 3 year or 1 year – which is also defined in the LTIP plan document.’*

23. The above explanation from Company D that the LTIP is not a share-based or stock-based compensation is consistent with the terms of the 2009 LTIP and 2015 LTIP respectively, for the following reasons:

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (1) Nowhere in the 2009 LTIP describes the Performance Units as shares or stocks in the Group or rights to acquire such shares or stocks. There are no rights for the participant to receive any dividends or interim payments from the Performance Units. There is no conferment of any shares/ stocks within the Group;
- (2) Similarly, nowhere in the 2015 LTIP describes the Performance Shares or RSUs as shares or stocks in the Group or rights to acquire such shares or stocks. There are no rights for the participant to receive any dividends or interim payments from the Performance Shares or RSUs. There is no conferment of any shares/ stocks within the Group;
- (3) For the 2009 LTIP, notwithstanding each Performance Unit is valued at the 'Grant Value' (US\$100) (Section 5) at the date of grant, the payment of the Performance Unit is made in accordance with its 'Terminal Value' (Section 6). According to the formula of calculating 'Terminal Value' under Section 2, the 'Terminal Value' at the date of grant cannot be determined as the average adjusted EBITDA for the 'Earnings Period' (ie the three-year fiscal period from the year of grant) cannot be ascertained. In fact, the 'Terminal Value' is not ascertainable until the average adjusted EBITDA for the 'Earnings Period' has been calculated after the expiry of the 'Earnings Period';
- (4) Similarly, for the 2015 LTIP:
  - (a) notwithstanding each Performance Share is notionally valued at the 'Performance Share Grant Value' (US\$100) (Section 4) at the date of grant, the payment of the Performance Share is made in accordance with the difference between its 'Ending Value' and the 'Performance Share Grant Value' (Section 5(a)). According to the formula of calculating 'Ending Value' under Section 5(a), the 'Ending Value' at the date of grant cannot be determined as the Pre-tax income of the Group of the third year cannot be ascertained at the time of grant, or anytime thereafter before the Pre-tax income of the Group has been calculated after the end of the third year of the grant.
  - (b) Likewise, notwithstanding each RSU is notionally valued at the 'RSU Grant Value' (US\$10) (Section 4) at the date of grant, the payment of a RSU share is made in accordance with its 'RSU Value' (Section 5(b)). According to the formula of calculating 'RSU Value' under Section 5(b), the 'RSU Value' at the date of grant cannot be determined as the Pre-tax income of the Corporation during the vesting period can only be calculated

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

after the expiry of the vesting period. In fact, the 'RSU Value' is not ascertainable until the end of each vesting period when the Pre-tax income of the Corporation for that vesting period has been calculated.

- (5) Unlike a share-based or stock-based compensation which value can be ascertained at the date of grant by reference to the share/stock price or valuation on any given day, the value of the Awards/ RSUs cannot be determined on the date of grant or during the period until the relevant average adjusted EBITDA/ Pre-tax income has been calculated after the expiry of the vesting period.

24. Having considered the terms of the two LTIPs, it is clear that the LTIPs operate in substance fundamentally different from a typical share/ stock option scheme, notwithstanding it was labelled in the LTIPs that the Awards and RSUs were being labelled as 'shares'/ 'units'. According to the terms of the two LTIPs, which is also confirmed by Company D, there is no entitlement to any shares/ stocks of the Group by participating in the LTIPs.

25. In determining what was the point in time the Appellant received the income under the LTIPs, these circumstances are relevant:

- (1) The value of the Awards and the RSUs cannot be ascertained at the date of grant or during the relevant period before the earnings have been calculated after the expiry of the vesting period. In each of the formulae for calculating the 'Terminal Value' (for Performance Units), 'Ending Value' (for Performance Shares) and 'RSUs Value' (for RSUs), it is made by reference to the future earnings of the Group which cannot be determined until the calculation of such earnings. For instance, if the future earnings or average future earnings of the Group is less than the earning in the year preceding the date of grant, then there will be no value for the Awards or RSUs (ie the employee will not receive any monetary payment at the end);
- (2) This is in contrast with typical share/ stock option which value can be ascertained on the date of grant or throughout any subsequent 'vesting period', being, in principle, the difference between the prevalent stock price and the option price;
- (3) The employee will only receive the payment in the year after the vesting period when the calculation of the entitlement has been made (by reference to calculation of the earnings during the vesting period). The payment of the Awards and RSUs is conditional upon the employee has remained in employment throughout vesting dates, subject to exceptions which are not applicable to the Appellant's case;



- (4) It is an express term in the two LTIPs that any transfer of the right to receive payment of the Awards or RSUs shall be void and unenforceable. Contrasting Ede v Wilson and Abbott v Philbin which the English Court recognizes the share option is freely convertible into money as the employee may at any time sell or raise money on the option notwithstanding the employee's undertaking not to sell, the same reason cannot apply to the two LTIPs as the transfer of right to receive payment is expressed to be void and unenforceable. As any transfer of the rights is void and unenforceable, it is impracticable for the employee to obtain any monetary value in his rights of the two LTIPs before their respective payment dates. The Appellant also does not produce any evidence of the monetary value of the Awards/ RSUs prior to the payment dates.

26. In other words, the Awards and RSUs are not 'actual money payments and to benefits in kind capable of being turned to money or which can be turned to pecuniary account or payments convertible to money or that which could be converted into money' (Heaton v Bell) at the date of grant or during the relevant period before the earnings have been calculated after the expiry of the vesting period. The Board finds that the Appellant could only obtain the pecuniary advantage of the Awards/RSUs at the time when the payments were made to him.

27. In the circumstances:

- (1) The grants of the Awards/ RSUs under the two LTIPs can only constitute income received by the Appellant at the time when he received actual money payments, so that income has accrued to him during the years of assessment when he received such payments within the meaning of section 11D(a) of the Ordinance (ie the years of assessment 2015/16 to 2017/18); and
- (2) The payments of the Awards/ RSUs are expressed to be payable in the subsequent year after their vesting period (see Section 6 of the 2009 LTIP and Section 5(d) of the 2015 LTIP). The Appellant was therefore only entitled to claim the payments in the subsequent year after the vesting period of the Awards/ RSUs. Within the meaning of section 11D(b), the income has only accrued to Appellant during the years of assessment (ie the years of assessment 2015/16 to 2017/18) when the payments were made to him (as and when the payments became payable). There is also no evidence from the Appellant that he was entitled to claim the payments prior to the payment dates.

### **Other arguments from the Appellant**

28. In advancing the arguments that LTIP Payments were accrued prior to the year of assessment of 2015/16, the Appellant made the following additional arguments:

- (1) The LTIP Payments during the years of assessment 2015/16 to 2017/18 were in relation to the period when the Appellant was under the City G secondment;
- (2) Section 11D(b)(i) of the Ordinance deems lump sum payment to be accrued over a maximum period of 36 months;
- (3) Reference should be made to the guidance on LTIP and deferred compensation plans published overseas and accounting standards in construing the meanings of ‘accrued’, ‘has accrued’ or ‘accrues’ under Section 11D of the Ordinance.

***Whether the LTIP Payments were in relation to the City G secondment prior to 2015/16***

29. The Board does not accept the Appellant’s argument that the LTIP Payments during the years of assessment 2015/16 to 2017/18 were in relation to the period when the Appellant was under the City G secondment prior to 2015/16 for the following reasons:

- (1) First, the payments of LTIPs are linked to achieved growth of the Group B’s consolidated earnings during a given period, but not to individual performance of an employee during the given period;
- (2) Second, the express purpose of the two LTIPs is ‘to assist the Corporation in retaining highly competent management and to attract additional persons of outstanding competence to serve as officers and key employees of the Corporation’. Coupled with the fact that the payments of the LTIPs were made by reference to a future ‘terminal value’/ ‘ending value’ conditional upon the employee staying in employment throughout the period, it is plain that that LTIPs are to reward future performance, but not past performance of an individual employee; and
- (3) Third, the fact that the Appellant had not received any pecuniary advantage before the payment dates reinforce the income only accrued on the payment dates but not before.

***Section 11D(b)(i) of the Ordinance***

30. Section 11D(b)(i) of the Ordinance provides:

***‘(i)any lump sum payment received on or after 1 April 1966, being a lump sum payment or gratuity paid or granted upon the retirement from or termination of any office or employment or any contract of employment of an employee or a lump sum payment of deferred pay or arrears of pay arising from an award of salary or wages, whether such a payment is paid by an employer to a person during employment or after that person has left***

*his employ, shall upon the application in writing of the person entitled to claim payment thereof within 2 years after the end of the year of assessment in which the payment is made be related back and shall then be deemed to be income which has accrued during the periods in which the services or employment, in respect of which the payment was made, were performed or exercised, or; if the relevant periods of service or employment exceed 3 years, the payment shall be deemed to be income accruing at a constant rate over the 3 years ending on the date on which the person became entitled to claim payment thereof or ending on the last day of employment, whichever is the earlier; and, notwithstanding section 70, an application made by any person under this proviso for the adjustment of an assessment shall, to that extent, be regarded as a valid objection to the assessment under section 64' (**emphasis added**).*

31. It is clear that section 11D(b)(i) of the Ordinance does not assist the Appellant because:

- (1) the LTIP Payments were not being paid to the Appellant arising upon his retirement or termination of employment; and
- (2) the LTIP Payments were not lump sum payments of deferred pay or arrears of pay. The LTIP Payments were paid to the Appellant when they became payable.

***Meaning of 'accrued'***

32. The Appellant further cited EIM40016 and EIM40014 of the internal manual of the HM Revenue & Customs of the United Kingdom, which provide:

EIM40016:

***'The year that earnings are "for" - Long Term Incentive Plans and Deferred Remuneration - staged vesting***

*Some Long Term Incentive Plans (LTIPs) pay out awards in tranches. The details of different schemes will vary. For example, an LTIP fund containing deferred bonuses and matching awards may pay out 20% per annum over five years or nothing in Years 1 and 2 and 33% per annum in Years 3 to 5. Entitlement may be conditional upon participants meeting performance conditions and remaining in employment.*

*The period that each tranche is 'for' has to be determined. If the evidence shows that the Plan is intended to reward performance over the period from award to vest, each part of the final payment is 'for' the period from the original award date until it vests, calculated as per Section 16(4) on a just and reasonable apportionment. In the first example, 20% is 'for' Year 1; 20% is 'for' Years 1 and 2, and so on. Alternatively, if there are no*

*performance conditions and the Plan emphasises being in employment at each vesting date, each payment may be treated as earnings ‘for’ the tax year of receipt.’*

EIM40014

***‘The year that earnings are “for” - Long Term Incentive Plans and Deferred Remuneration***

*Various schemes exist to reward and provide incentives to employees. Not all intended outcomes will be the same. The intention of the employer and the intended behavioural effect will influence the design of the scheme. For example, plans may be intended to:*

- *Tie-in valued employees and create a disincentive for leaving and moving to a competitor; or,*
- *Motivate and reward outstanding performance by aligning the interests of employees with those of the shareholders*

*Schemes intended to aid retention may include the following features:*

- *Bonuses are paid after 3 – 5 years of satisfactory employment*
- *The employer has discretion to award or deny bonuses for good or bad leavers*
- *Part bonuses are paid year on year with other entitlement remaining in the Plan*
- *Part entitlement to bonuses ‘vests’ each year, but is not paid until a later year*

*Schemes intended to motivate and reward outstanding performance may include:*

- *Employment targets linked to growth in the company’s:*
  - *share price*
  - *turnover*
  - *net profits*
  - *expansion of certain markets*
  - *market share*

...  
*Awards from both types of schemes are likely to be ‘for’ the whole performance or reference period. If this is greater than one tax year then the final award should be apportioned over the tax years falling into the performance period on a reasonable basis.’*

33. The Appellant argues that, by reference to the HMRC Internal Manual, as the ‘terminal value’ of the Awards and RSUs depended on the growth in pre-tax income of

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

the Group over the relevant vesting period, the 2009 LTIP and 2015 LTIP are ‘for’ the whole performance or reference period. In other words, the Appellant argues that the income from the LTIPs accrued during the whole performance or reference period, instead of on their payment dates.

34. The Appellant’s argument must be rejected, for the following reasons:

- (1) The HMRC Internal Manual is of limited relevance (if not no relevance) to the construction of Section 11B and 11D of the Ordinance, and is not binding on the IRD;
- (2) EIM40016 provides that ‘if there are no performance conditions and the Plan emphasizes being in employment at each vesting date, each payment may be treated as earnings ‘for’ the tax year of receipt’. There is no performance conditions imposed on the participants under the two LTIPs, thus even according to EIM40016, each payments may be treated as earnings ‘for’ the tax year of receipt (ie payment dates).
- (3) EIM40014 recognizes each scheme may be of different design. The design of the two LTIPs must be construed according to their own terms. In the Board’s view, the fact that the Appellant had not received any pecuniary advantage throughout the performance/reference period until the payment dates manifest the intention of the LTIPs that income only accrued to the Appellant on the payment dates, but not before.

35. The Appellant further sought to rely on the ‘US special timing rule for deferred compensation plans’ that employers in the US are required to withhold Federal Insurance Contribution Act taxes for deferred compensation plans upon the later of (a) when services are performed; or (b) when there is no longer ‘a substantial risk of forfeiture’. The Appellant said that, by virtue of the rulings in Tadjudin Sunny v Bank of America, National Association [2016] HKCA 201 and CIR v Poon Cho-ming, John [2019] HKCFA 28, there has been no ‘substantial risk of forfeiture’ throughout the reference period. The Appellant sought to argue that by the application of the ‘special timing rule’, an employee can make claims against the employer as general creditors in case of payment default and this supports the contention that the LTIP Payments were earned by the Appellant when services were performed throughout the reference period.

36. Again, the Board rejects this argument for the simple reason that the analogy to the ‘US special timing rule for deferred compensation plans’ is unhelpful. Company D is a Hong Kong employer and there is no evidence (let alone expert evidence) before the Board that the ‘US special timing rule’ is applicable. The Board agrees with the Commissioner that no reasonable analogy can be drawn. The Board also does not need to deal with the principles in Tadjudin Sunny and Poon Cho-ming as they are irrelevant to the issue of timing of assessment in this case.

37. The Appellant further seeks to argue that in the construction of ‘accrued’ under Section 11D(a) of the Ordinance, reference has to be made to relevant accounting standards. The Appellant argues that under Hong Kong Accounting Standard 19 (employee benefits) (**‘HKAS 19’**) issued by the HKICPA, an employer *‘shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also any constructive obligation that arises from the entity’s informal practices’* and that *‘employee service before the vesting date gives rise to a constructive obligation’*. The Appellant argues that as the employer is required to accrue the liability on long term employee benefits in relation to the employee services when the services are received no matter whether it is a legal or constructive obligation, the income must have accrued to the Appellant at the time when the employment served were performed during the reference period before the payment dates. The Appellant also relies on Hong Kong Financial Reporting Standard 2 (Share-based Payment) (**‘HKFRS 2’**) to advance this proposition.

38. Again, the Board rejects this argument, for the following reasons:

- (1) HKAS 19 and HKFRS 2 refer to the accounting standards on the employer. Section 11B of the Ordinance makes reference to income accruing to the employee. Section 11D of the Ordinance further provides that for the purpose of Section 11B of the Ordinance, (a) income which has accrued to a person which has not been received by him shall not be included until he shall have received such income; and (b) income accrues to a person when he becomes entitled to claim payment thereof. It is clear from these distinctions the accounting standards on the employer has no relevance;
- (2) Consistent with the above, the Board has previously held in:
  - a. D26/07 (2007-08) 22 IRBRD 601 that Section 11D(b) of the Ordinance is to assist in determining when should an item be taxed and it does not mean that a person who is entitled to receive income but has never received it can be taxed under section 8 of the Ordinance; and
  - b. D46/05 (2005-06) 20 IRBRD 110 that what an internal document of an employer described the year of the bonus payment was not a conclusive evidence to ascertain the time when the bonus accrued to the employee.
- (3) Further, the Commissioner submits that in Nice Cheer Investment Limited v CIR (2013) 16 HKCFAR 813, the Court of Final Appeal held that the role of the principles of commercial accounting and accounting standards in the operation of the Ordinance that accounting standards are directed to the preparation of financial statements and not tax computations, and that the two serve different purposes. The Board agrees.

39. The Appellant also made the point that the LTIP Payments are income under section 9(1)(d) of the Ordinance, and therefore the assessing practice under Departmental Interpretation and Practice Notes No. 38 issued by the IRD should apply in calculating the taxable amount in that the taxability of the LTIP Payments depended on where the Appellant was rendering his services at the time when the right of the benefits was derived, not when he subsequently exercised the right. The Appellant went on to suggest that as the LTIP Payments fall under section 9(1)(d) of the Ordinance, it should be excluded from the calculation of the rental value of the place of residence provided by the employer.

40. The Board rejects this argument, for the following reasons:

- (1) Section 9(1)(d) of the Ordinance includes income of *‘any gain realized by the exercise of, or by the assignment or release of, a right to acquire shares or stock in a corporation obtained by a person as the holder of an office in or an employee of that or any other corporation.’* The two LTIPs do not provide for any right to acquire any shares or stock in a corporation, and therefore the LTIP Payments do not fall under Section 9(1)(d) of the Ordinance;
- (2) Likewise, reliance on paragraphs of Departmental Interpretation and Practice Notes No. 38 is misplaced as those paragraphs were related to share option benefits which were income falling under section 9(1)(d) of the Ordinance and are therefore not applicable to the LTIP Payments;
- (3) The LTIP Payments were obviously perquisites as described in section 9(1)(a) of the Ordinance and should be included in the calculation of rental value under section 9(2) of the Ordinance.

### **Source of Appellant’s employment**

41. For the purpose of completeness and insofar as it is necessary, the Board also finds that the Appellant’s employments remained sourced in Hong Kong since the Commencement Date, for the following reasons:

- (1) The Appellant was granted continuity of employment with Company D, from the Commencement Date;
- (2) It is trite law under Commissioner of Inland Revenue v Goepfert [1987] 2 HKTC 210 that section 8(1) of the Ordinance is the basic charge which imposes liability to Salaries Tax on income arising in or being derived from an employment in Hong Kong. It held that if during a year of assessment a person’s income fell within the basic charge to Salaries Tax under section 8(1) of the Ordinance, the entire salary was subject to Salaries Tax irrespective of the place where the services were rendered by the person unless the person can claim relief by way of exemption under the 60-day rule under section

8(1A)(b) as read with section 8(1B) of the Ordinance. Once income was caught by section 8(1), there was no provision for apportionment. The place where the services was rendered was relevant to the question only under the extended charge created by section 8(1A)(a) of the Ordinance in the event that income of a person did not fall within the basic charge under section 8(1) of the Ordinance, ie income from non-Hong Kong employment;

- (3) Further in Lee Hung Kwong v Commissioner of Inland Revenue [2005] 4 HKLRD 80, it was held that secondment does not necessarily change the location of employment. It depends on the terms of the secondment and in particular and ultimately where the income source of the income. The Appellant's secondment in City G therefore cannot change his employment with Company D in Hong Kong;
- (4) The Appellant has not produced any evidence in relation to separate employment contract with the Group during his secondment in City G, other than the employment letters and addendum between the Appellant and Company D. There is nothing to substantiate the Appellant's assertion that the secondment in City G was arranged under the employment with Company D for administrative convenience only in managing all expatriates working in City G.

### **Conclusion**

42. The Board therefore rejects the Appellant's arguments and accepts that the LTIP Payments have been correctly assessed in the years of assessment 2015/16 to 2017/18 and the Appellant has failed to discharge the onus of proving that the LTIP Payments should be assessed in the years of assessment 2008/09 to 2014/15.

43. As the Board holds that the LTIP Payments should be accrued to the Appellant in the years of assessment 2015/16 to 2017/18, the Appellant's exemption claim in respect of the LTIP Payments in the years of assessment 2008/09 to 2014/15 is irrelevant to this appeal. In any event, the Board finds that the Appellant's employments remained sourced in Hong Kong since the Commencement Date.

44. For the aforesaid reasons, this appeal is dismissed.