

Case No. D5/23

Salaries tax – whether the payment was a reward for past service or a payment to induce the employee to enter into employment and provide future service – nature of ex-gratia payment – the substance of settlement – whether the disputed payment represents a claim of the employee’s entitlement – whether the rights has been abrogated – whether legal fee were incurred in the performance of the job duties – salaries received from garden leave period

Panel: Hau Pak Sun (chairman), Chiu Chi Kong and Ho Sai Man.

Date of hearing: 8 December 2020.

Date of decision: 21 June 2023.

The appellant was an employee of Company B. Her remuneration consisted of monthly salary and annual bonus. The bonus was payable at the sole discretion of the Employer and was a performance related incentive each year based on the employee’s performance as well as the business performance of the employee’s business division and the Employer as a whole.

Unsatisfied with the significant reduction of bonus, in July 2017 the Appellant initiated legal proceedings against the Employer in the Labour Tribunal for a claim of unreasonable reduction of bonus for 2016. After the case was transferred to the Court of First Instance, the Employer and the Appellant reached an agreement that the legal proceedings would be settled by an ex-gratia cash payment payable in two tranches in Sum A and B and the Appellant’s employment with the Employer would be terminated. The Taxpayer claimed that the entire Ex-gratia Payment is not chargeable to Salaries Tax. In the course of the dispute with the Employer, the Appellant claimed that she had incurred legal fees and claimed deduction of the legal fees from her Salaries Tax.

The Commissioner of Inland Revenue accepted that Sum B was not taxable for the Appellant’s Salaries Tax. The Commissioner however considered that the Sum A was the Appellant’s income from her employment with the Employer and therefore should be chargeable to Salaries Tax and the Commissioner also considered that payment of the legal fees by the Appellant for the purpose of resolving her dispute with the Employer was expenses of a private nature and those expenses were not incurred in the performance of her employment duties. Hence the legal fees were not deductible under Salaries Tax.

In the appeal, the Appellant argued that the entire Ex-gratia Payment was a compensation of the loss of the Appellant’s office and other detrimental treatments and damage caused by the Employer, which was not related to any entitlement under the Appellant’s employment contract but was made in consideration of the Appellant’s agreement to surrender her legal rights against the Employer. Secondly, the Appellant claimed that the legal fees she spent was necessary for her in the production of gaining

(2023-24) VOLUME 38 INLAND REVENUE BOARD OF REVIEW DECISIONS

assessable income; Thirdly the Appellant claims that the salary in the Sum C the Appellant received after she was removed from the Employer's work premises until the termination of her employment should not be subject to Salaries Tax.

Held:

1. 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 (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74; and Commissioner of Inland Revenue v Poon Cho Ming, John (2019) 22 HKCFAR 344 followed).
2. In the circumstances, the nature of the Ex-gratia Payment or precisely Sum A will have to be examined closely in order to determine whether it was in substance a reward of past service. For instance, if Sum A was in substance an income from employment (such as discretionary bonus or compensation of discretionary bonus entitlement), then regardless of whether it is labelled as something else (for example, an out of court settlement sum), it is still chargeable to salaries tax. Further, as the Commissioner submits and the majority of this Board accepts, 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.
3. As the majority of the Board finds that the claim of the Sum A represents a claim of reduction of bonus from the Appellant but not something else, the next question is what is the substance of settlement sum from the Employer paid to the Appellant of such claim? To answer this question, one must consider whether the Appellant was entitled to bonus payment at the first place and whether the purpose of the payment was in order for the employer to perform its obligations under the contract. If the answer is 'yes', then it must follow that the payment was income 'from' employment.
4. Employers and employees from time to time have disputes over their entitlements in the course of their employment. As long as it can be shown that the disputed payment represents a claim of the employee's

(2023-24) VOLUME 38 INLAND REVENUE BOARD OF REVIEW DECISIONS

entitlement (for example, for past services), the purpose of the payment (even if it was disputed by the employer) must be in order for the employer to perform its obligations under the contract, as its obligations would have been discharged once the payment has been made (even if it was disputed).

5. Having found that the substance of the payment of Sum A represents the Appellant's entitlement, it matters not that it might linguistically be acceptable also to refer to it as 'compensation for loss of office' or something similar (for example a settlement sum) by the Employer. In any event, the Commissioner has already accepted that part of the Ex-gratia Payment (ie Sum B) is excluded from the Appellant's assessable income, as Sum B could be interpreted as a settlement sum of the Appellant's other personal claims against the Employer which was '*something else*' (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 followed).
6. The fact that under the Employment Contract bonus would not be payable if a termination notice has been served would also not alter the substance of the payment. The test is whether the payment was in substance a reward of past service made by the employer. An employer can always waive the restriction in the Employment Contract by remunerating the employee even though the employer is under no legal obligation to do so. This is similar to bonus payment which the employer is not under a contractual obligation to pay, nonetheless the payment would be subject to Salaries Tax.
7. The Board has also carefully reviewed the agreement from the perspective of whether the Appellant's rights had been 'abrogated'. Other than the settlement of the High Court Action (which had already been taken into account by the Commissioner in excluding Sum B from the Appellant's assessable income in relation to the additional claim on top of loss of bonus), there is no other rights which the Appellant has abrogated other than a release of the Employer's liability (which has already been factored in the settlement). The Appellant's argument that the Ex-gratia Payment is subject to claw-back by the Employer is neither here nor there as there is no evidence that the Employer has exercised its right for the claw-back.
8. In the circumstances, the majority of this Board upholds the Commissioner's Determination that Sum A was the Appellant's income from her employment with the Employer and therefore should be chargeable to Salaries Tax.
9. The Board considered that the legal fees were not incurred in the performance of the Appellant's job duties, and they were incurred because of circumstances personal to the Appellant in her ongoing dispute with the Employer. It cannot be said that the Legal Fees were incurred by the Appellant in the production of her assessable income. The Board therefore

upholds the Commissioner's Determination that the Legal Fees were not deductible under Salaries Tax (Commissioner of Inland Revenue v Robert P Burns [1980] 1 HKTC 1181 followed).

10. Notwithstanding the Appellant was granted garden leave and was not required to report to work during the garden leave period, it is undisputed that the Appellant remained in her employment with the Employer until the termination of her employment and she was entitled to employee benefits during such period. The garden leave provision is also provided in the Employment Contract. It is up to the Employer's choice to serve a termination notice of employment and require the employee to remain as an employee until the expiry of the termination notice (albeit under a garden leave), and in that case the salaries the employee receives during the notice period would be her assessable income and chargeable to Salaries Tax. This Board therefore holds that Sum C is chargeable to the Appellant's Salaries Tax (D80/03 18 IRBRD 820 followed).

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
Ricketts v Colquhoun 10 TC 118
Brown v Bullock 40 TC 1
Commissioner of Inland Revenue v Robert P Burns [1980] 1 HKTC 1181
D80/03, IRBRD, vol 18, 820
Henley v Murray [1950] 1 All ER 908

Appellant in person.

Yu Wai Lim and Ching Wa Kong, for the Commissioner of Inland Revenue

Decision:

Section A: Majority Decision of Chairman Hau Pak Sun and Member Chiu Chi Kong

Introduction and the appeal grounds

1. Ms A ('**the Appellant**') was an employee of Company B ('**the Employer**') from 2014 to February 2018 as a Position C in the equities department (with corporate title as a Position D). Her remuneration consisted of monthly salary and annual bonus. The bonus was payable at the sole discretion of the Employer and was a performance related incentive each year based on the employee's performance as well as the business

(2023-24) VOLUME 38 INLAND REVENUE BOARD OF REVIEW DECISIONS

performance of the employee's business division and the Employer as a whole.

2. The Appellant's discretionary bonus for the years of 2014 and 2015 were HK\$1,250,000 and HK\$2,088,500 respectively. In 2016, for reasons to be elaborated below, her discretionary bonus was reduced to HK\$392,000 only.

3. Unsatisfied with the significant reduction of bonus, in July 2017 the Appellant initiated legal proceedings against the Employer in the Labour Tribunal for a claim of unreasonable reduction of bonus for 2016 with a claim amount of HK\$1,700,000. After the case was transferred to the Court of First Instance, the Employer and the Appellant reached a termination agreement dated 17 November 2017 (**'Termination Agreement'**, also defined as the **'Settlement Agreement'** in the dissenting opinion of Member Ho Sai Man in Section B below) that the legal proceedings would be settled by an ex-gratia cash payment of HK\$3,700,000 (**'Ex-gratia Payment'**) payable in two tranches (in the sum of HK\$1,700,000 (**'Sum A'**) and HK\$2,000,000 (**'Sum B'**)). The Termination Agreement also provides that the Appellant's employment with the Employer would be terminated on 28 February 2018 and the last day on which the Appellant was expected to report for work would be 15 December 2017. The Taxpayer claimed that the entire Ex-gratia Payment is not chargeable to Salaries Tax.

4. In the course of the dispute with the Employer, the Appellant claimed that she had incurred a sum of HK\$191,204 on legal fees (**'the Legal Fees'**). The Appellant also claimed deduction of the Legal Fees from her Salaries Tax.

5. In the Commissioner's determination dated 5 August 2020 (**'the Determination'**):

- (1) The Commissioner of Inland Revenue (**'the Commissioner'**) accepted that Sum B is not taxable for the Appellant's Salaries Tax;
- (2) The Commissioner however considered that the Sum A was the Appellant's income from her employment with the Employer and therefore should be chargeable to Salaries Tax for the year of assessment 2017/18; and
- (3) The Commissioner also considered that payment of the Legal Fees by the Appellant for the purpose of resolving her dispute with the Employer was expenses of a private nature and those expenses were not incurred in the performance of her employment duties. Hence the Legal Fees were not deductible under Salaries Tax.

6. In this appeal, the Appellant's grounds of appeal against the Determination can be summarized as follows:

- (1) The entire Ex-gratia Payment was a compensation of the loss of the Appellant's office and other detrimental treatments and damage caused by the Employer, which was not related to any entitlement

under the Appellant's employment contract but was made in consideration of the Appellant's agreement to surrender her legal rights against the Employer;

- (2) But for the issue of the solicitors' letter by the Appellant to the Employer between March and November 2017, the Appellant would have been dismissed by her Employer already and the Appellant would not be able to receive any assessable income until February 2018. The Appellant therefore claims that the Legal Fees she spent was necessary for her in the production of gaining assessable income (in the form of salary) for the period from March 2017 to February 2018; and
- (3) The Appellant claims that as she was removed from the Employer's work premises from 1 December 2017, the salary in the sum of HK\$500,001 ('**Sum C**') the Appellant received from 1 December 2017 until the termination of her employment on 28 February 2018 should not be subject to Salaries Tax.

Underlying facts and evidence

7. Before the hearing, the Appellant by an email dated 27 November 2020 agreed Facts (1) to (14) as set out in Part 1 of the Determination under 'FACTS UPON WHICH THE DETERMINATION WAS ARRIVED AT' are factual. These facts are produced in Annex 1 and, save as to Facts 1(12)(d) which have been qualified by the Appellant during the hearing as elaborated in footnote 3 at paragraph 17 below, form part of the fact findings of this Board. The salient facts are recited below.

8. The Appellant testified as the only witness in the present appeal.

9. The Appellant's employment contract with the Employer dated 10 April 2014 ('**Employment Contract**') contains, among other things, the following terms and conditions:

Base remuneration

- (1) Clause 4.1: The Appellant's base remuneration was at the annual rate of HK\$1,850,000, payable in arrears in each month;

Discretionary Performance Incentive

- (2) Clause 5.1: The Appellant might be eligible for consideration for a performance related incentive each year based on a variety of factors, including, without limitation, her individual performance and contribution (including financial and non-financial objectives), that of her business area and business division, and the overall performance of the Employer during the calendar year ending 31

December, as well as any applicable regulations or law which might affect individual incentive awards;

- (3) Clause 5.2: Any such incentive was granted at the sole discretion of the Employer and accordingly the Appellant should have no contractual entitlement whatsoever to such an incentive. The Appellant acknowledged that the amount of the incentive was at the sole discretion of the Employer (and that such amount might be nil), and that the grant of an incentive award in any year should not give rise to any obligation to make subsequent incentive award(s) in any other year;
- (4) Clause 5.4: This performance incentive was usually disbursed during the first quarter of the subsequent year. No payment of any incentive would be made if the Appellant was not in employment with the Employer at the date of payment or if either the Appellant or the Employer had given notice of termination on or before that date;

Termination

- (5) Clause 8.1: The Appellant's employment might be terminated in writing at any time by the Employer or the Appellant by giving three months' notice of termination or payment in lieu of notice by the Employer where her employment was terminated by the Employer;

Garden leave

- (6) Clause 9.1 and Clause 9.2 of the Employment Contract provide that in the event either the Appellant or the Employer has served a notice of termination, the Employer might suspend the Appellant from work duties and/or access to work premises on full pay and contractual benefits.

Other terms

- (7) The Employment Contract provides non-competition and non-solicitation restrictions during her employment and for three/ six months after notice of termination (Clauses 12 and 13) and confidentiality obligation during and after the employment (Clause 15).

10. In December 2016, the Employer conducted an investigation in relation to the Appellant's claim of reimbursement of expenses. The investigation was followed by a final written warning issued to the Appellant in February 2017 ('**Warning Letter**') which stated, among other matters, the Employer's findings of the Appellant's conduct as unacceptable, and that the Appellant's performance rating and compensation for 2016 might be affected by such disciplinary matter.

(2023-24) VOLUME 38 INLAND REVENUE BOARD OF REVIEW DECISIONS

11. As the result of the Warning Letter, the Employer only paid the Appellant a bonus of HK\$392,000 for the performance year of 2016 which was *‘a lower sum than she would have otherwise received had she not been subject to the [Warning Letter]’*. The Employer stated that the bonus of an employee having received a final written warning was expected to be reduced by at least 50%.

12. By a letter dated 23 March 2017, the Appellant’s solicitors (Solicitors G) wrote to the Employer claiming that the Warning Letter was issued on an unreasonable basis leading to the substantial reduction of the Appellant’s bonus (reduced to HK\$392,000 for 2016 from the Appellant’s discretionary bonus for the years of 2014 and 2015 amounting to HK\$1,250,000 and HK\$2,088,500 respectively). The Appellant disputed, with her reasons, that there was no breach of employment guidelines/ handbook in her reimbursement claim and she disputed the findings of the investigation by the Employer. The Appellant demanded the Employer to, among other things, withdraw the Warning Letter, readjust her performance ratings and recalculate her discretionary bonus for year 2016. The letter, however, does not specify the amount which the Appellant claims against the Employer.

13. Apparently the Appellant’s demand was not met with satisfactory response from the Employer. On 6 July 2017, the Appellant commenced legal proceedings against the Employer in the Labour Tribunal (case number LBTC XXXX/XXXX). The Appellant claimed against the Employer for *‘Unreasonable reduction of bonus for 2016’* and the claim amount was stated to be HK\$1,700,000.

14. The Labour Tribunal case was scheduled for a call-over hearing on 1 August 2017. By an order dated 1 August 2017, the Presiding Officer of the Labour Tribunal ordered that:

- (1) leave was granted to the Appellant to amend the particulars of claim;
and
- (2) the Appellant’s claim be transferred to the Court of First Instance.

15. The reasons why the Labour Tribunal case was transferred to Court of First Instance were explained by the Appellant in her letter to the Commissioner:

‘During my employment with [the Employer] (particularly during 2016 and 2017) [the Employer] had imposed a series of unfair treatments to me, including sex discrimination, workplace bullying, retaliation/ victimization etc, which have led to substantial career damage and psychiatric injury to me. Even if I was treated very badly during my employment, I had kept quiet until March 2017 when I realized that [the Employer] were trying to make a Constructive Dismissal to me, I hired [Solicitors G] as my solicitor to protect my right and sent a lawyer letter to [the Employer] with some fair requests for the justice. However, after several rounds of lawyer letters, [the Employer] still ignored my rights and didn’t try to correct any

of their mistakes and rejected all my reasonable requests which were listed in [the letter from Solicitors G dated 23 March 2017].

Given the abusive system within [the Employer] the justice can't be given. I had to look for justice outside of [the Employer]. To save lawyer fees, I first tried to make a claim at Labour Tribunal, given in Labour Tribunal court I can present for myself without hiring my lawyers. After the Labour Tribunal inspector reviewed my case, he told me in the court in front of [the Employer's] representative: Obviously you (ie [the Appellant]) have received a serial of serious unfair treatment from [the Employer], and the High Court is the right place to handle your case. If you make your claim through the High Court, you could get 10 times higher of compensation than what you are asking now and there would be professional lawyers to help you make your claim. If you agree, I can transfer your case to the High Court.'

16. To corroborate the Appellant's evidence, the Appellant also produced a statement¹ which she said she submitted to the Labour Tribunal in July 2017 detailing the particulars of allegations of unfair treatments from the Employer leading to substantial financial loss, career damage and psychiatric injury to the Appellant, although the Appellant did not quantify her loss and damage in her statement. The Appellant, however, acknowledged that the statement had not been copied to the Employer.

17. In a letter from the Employer to the Commissioner dated 9 January 2020, the Employer described what had happened at the call-over hearing in Labour Tribunal on 1 August 2017:

*'During the call-over hearing on 1 August 2017 before the [Labour] Tribunal, [the Appellant] verbally amended her claim to be HKD3,700,000 (which we understood to comprise of HKD2,700,000 for her previously raised bonus claim and HKD1,000,000 for an additional claim for loss of pay rise). Her claims were not particularized and the case was withdrawn before a Statement of Claim was filed with the Court.'*²

18. The Labour Tribunal case was thereafter transferred to the Court of First Instance by the action number of HCA XXXX/XXXX (**'the High Court Action'**). No statement of claim had been filed by the Appellant.

19. Subsequently, there were ongoing settlement negotiations between the Employer and the Appellant, although documentary evidence of these negotiations was not made available before this Board. The Employer and the Appellant signed the Termination Agreement in November 2017. The Termination Agreement provided, among other

¹ The statement was produced to the Board in its draft form in the circumstances as elaborated in the dissenting opinion of Member Ho Sai Man at paragraph 88 below.

² Despite the content of this paragraph forms part of the admitted fact under paragraph 1(12)(d), the Appellant at the end of the hearing clarified that she mentioned the amendment of her claim to HK\$3.7 million one day prior to the call-over hearing to an officer in the Labour Tribunal instead of during the call-over hearing.

things, the following material terms:

- (1) The last day on which the Appellant was expected to report for work would be 15 December 2017 and her employment with the Employer would be terminated on 28 February 2018 (Clause 1). The Appellant would continue to be paid her base remuneration up to and including 28 February 2018 (Clause 2.1). From 16 December 2017 to 28 February 2018, the Appellant was required to go on garden leave (Clause 4);
- (2) The Appellant would be paid an ex-gratia cash payment in the amount of HK\$3,700,000 (ie the Ex-gratia Payment) to be paid out in two tranches (Clause 5.1):
 - a. the first tranche of payment of HK\$1,700,000 (ie Sum A) was to be paid no later than 29 November 2017 provided that the Termination Agreement was signed no later than 27 November 2017 and conditional upon the Appellant's filing of the Consent Order dismissing the High Court Action;
 - b. the second tranche of payment of HK\$2,000,000 (ie Sum B) was to be paid within 2 business days of 28 February 2018, subject to the Appellant's continued compliance with the terms set forth in the Termination Agreement and subject to her executing a separate Release on 28 February 2017.
- (3) The Ex-gratia Payment would be subject to claw-back by the Employer if the Appellant had violated the terms of the Termination Agreement (Clause 5.2);
- (4) The arrangements set out in the Termination Agreement shall be in full and final settlement of the High Court Action, all claims and disputes arising out of or in connection with the High Court Action and all other claims, costs, demands, complaints, expenses and rights of action of any kind whatsoever or howsoever arising which the Appellant had then or might have any time in the future against the Employer (Clause 10.1). Save as to the enforcement of the Termination, the Appellant undertook not to commence any legal or arbitral proceedings against the Employer, and that the Appellant shall dismiss her claim in the High Court Action with no order as to costs (Clause 10.2);
- (5) It was stated that save as set out in the Termination Agreement, the Appellant should have no entitlement to any other payment or benefit from the Employer, whether by way of wages, bonus or otherwise (Clause 2.9). In particular, it was an express term that the Appellant

(2023-24) VOLUME 38 INLAND REVENUE BOARD OF REVIEW DECISIONS

would not be eligible for discretionary incentive award for performance year 2017 or 2018 (Clause 2.6); and

- (6) In addition, the Appellant was reminded of her confidentiality duties, and the restrictive covenants on non-solicitation and non-competition (Clauses 6 and 7).

20. The Appellant signed a release of all liability in favor of the Employer on 28 February 2017 and her employment was terminated on the same day. It is undisputed that the Appellant received the full amount of the Ex-gratia Payment under the Termination Agreement, and that her dispute with the Employer had been fully and finally settled.

21. In support of the Appellant's case, the Appellant relied on an email dated 7 November 2019 from Ms E, Head of Human Resources of the Employer, which the Employer claimed that:

- (1) The Ex-gratia Payment was not for the Appellant's bonus in 2016, 2017 and 2018, nor did it represent the Appellant's salary or reward based on the Appellant's 2016, 2017 or 2018 performance;
- (2) Withdrawing the High Court Action and the signing of the release letter was another prerequisite to receive the Ex-gratia Payment.

22. The Appellant's evidence is that after the transfer of the Labour Tribunal case to the High Court, the Employer started serious negotiation with the Appellant. Whilst the Appellant was told that she would not have a future at the Employer given the disputes between them, the Employer could give her a compensation for her unemployment provided that the Appellant discontinues the High Court Action. The Appellant claimed that the base for the Employer to propose the settlement amount was a standard redundancy package which covers the loss of office.

23. On the nature of the Ex-gratia Payment, the Appellant further relied on the explanation from the Employer which the Employer wrote in the following terms:

'Without admission of liability to [the Appellant's] claims, [the Employer] agreed to her request for an ex-gratia payment of HKD3,700,000 in order to settle the High Court action and any and all other claims. The full amount of HKD3,700,000 is a settlement payment and consideration for [the Appellant's] written acceptance and adherence to the separation agreement. It was not a bonus payment, salary payment or reward to [the Appellant]. There are no open inter-partes correspondence in relation to the negotiation of the ex-gratia payment.' (The Employer's letter to the Commissioner dated 9 January 2020).

24. As to why the Ex-gratia Payment was split into two tranches (in Sum A and Sum B), the Appellant relied on another written explanation from the Employer (in its letter to the Commissioner dated 7 May 2020) that the Appellant wanted some payment before

(2023-24) VOLUME 38 INLAND REVENUE BOARD OF REVIEW DECISIONS

she dismissed the High Court Action, and that the split was arbitrary and the first tranche (Sum A) did not represent a bonus payment. The Employer further explained that in addition to the impact of the Warning Letter, the discretionary incentive amount was also less than the amount awarded for the performance year 2015 because the Employer's bonus pool for 2016 was smaller than that of 2015.

25. The Ex-gratia Payment was initially reported by the Employer in the Employer's Return (dated 19 April 2018) to the Inland Revenue Department under 'Other Rewards, Allowances or Perquisites'. The Employer subsequently amended the Employer's Return (dated 6 August 2018) to report the Ex-gratia Payment under the item of 'Back Pay, Payment in Lieu of Notice, Terminal Awards or Gratuities' instead.

26. At the hearing, the Appellant explained that she arrived at the compensation amount of HK\$3,700,000 as compensation of her loss of earning for one year, plus damage for psychiatric injury and reputation damage. The Appellant testified that there was no way the Employer would adjust her 2016 bonus as the Employer was forcing her out starting with the Warning Letter and by September/ October 2017 the Appellant confirmed her belief that she would not have a future at the Employer's employment after she had commenced legal proceedings against the Employer. The Appellant therefore said that she changed her claim from '*a correction on my 2016 bonus*' to '*future career damage compensation*' and requested for future career loss to protect her future career. The Appellant explained that for the past few years she had earned about HK\$3.5 million to HK\$4 million a year, and therefore she came up with the figure HK\$3,700,000 as compensation for loss of 1-year earning.

27. The Appellant tried to clarify that the claim originally filed in the Labour Tribunal for claim of reduction of bonus was '*like a strategy than the real reason*' as '*the Labour Tribunal has a very limited scope on what they handle.*' The Appellant claims that had she submitted her claim based on psychiatric injury, future career loss or reputation loss, the Labour Tribunal would not have accepted her case in the beginning. The Appellant confirmed that immediately prior to the commencement of the Labour Tribunal action against the Employer, she had obtained legal advice from her then solicitors F to do so.

28. At cross-examination, the Appellant admitted that she believed she would be entitled to Sum A as her bonus for 2016 but for the Warning Letter:

Q: How the amount [HK\$1.7 million] is determined?

A: At that time, I think – that's the number I believe I would get because I would get without the final written warning; that's my own calculation or I think I deserve. Or put it this way, I think I deserve the bonus amount.

Q: That mean what you said in the morning you received [HK\$]390,000 something paid by [the Employer] in addition to the amount, if you add up this [HK\$]1.7 [million], that will be [HK\$] 2 million.

(2023-24) VOLUME 38 INLAND REVENUE BOARD OF REVIEW DECISIONS

A: Yes. But actually, okay, so in addition to this, right, as I also mentioned very clearly this morning, so this number I have to put it up like this even though I think maybe there is also no matter it's about the defamation, of ruining my career potential, or psychiatric injury. But because if I put, for example if I itemize say that's my career damage charge that's my psychiatric injury charge; and then the Labour Tribunal would say "This is not applicable in this court"; they will cross it out. So I would have to say, okay, then either adapt in a way and also make this number looks reasonable, reasonably within a certain range of my 2016 bonus.'

29. At the end of the hearing, the Appellant also agreed that but for the Warning Letter, the Appellant expected her 2016 bonus would be comparable to 2015, which was about HK\$2.08 million. For this reason, the Appellant admitted it was her intention that the HK\$1.7 million represented the shortfall between her actual entitlement of bonus in 2016 and her bonus received in 2015. The relevant part of the Appellant's testimony is recited as follows:

'Chairman: When you said that but for the final warning letter, you would have expected your 2016 bonus would be at least comparable to 2015 because your performance in 2016 was pretty good, as you said.

A: Yes similar.

...

Chairman: So can I ask you this question, when you put down [HK\$]1.7 million in your claim form initially, you actually had in mind that for your performance, that would be at least comparable to your 2015 performance. Your total bonus for 2016 would be similar, if not more than 2015; and that's why your claim of [HK\$]1.7 million adding up the [HK\$]392,000 received would be about a similar amount to your 2015 bonus. Was that your intention?

A: You could say that way. But with the big condition that I can keep my employment. Because like what I said, yes, if they give me that [HK\$] 1.7 [million], I will withdraw my case. They allow me to stay at [the Employer], I'd be very happy to pay the income tax for that additional [HK\$] 1.7 million I received as the adjustment of my 2016 bonus; because I have a career remain at [the Employer], I didn't lose my job.'

30. At the hearing, the Appellant insisted that Sum A did not represent her bonus because if Sum A indeed represented bonus, then the Appellant could stay in the job and she would pay for its Salaries Tax. However, at cross-examination, the Appellant testified:

'A: If it's only about the correction of my bonus, which I already said clearly when you show me lawyer letter; if [the Employer] accepted, we don't need to go to Labour Tribunal; and they will adjust my bonus, I pay

that part of the bonus of the tax and I save my employment. So the whole case evolve. That was my original plan even when I go to Labour Tribunal. If at that time, for example [the Employer] come to me saying, "I pay you this amount, bonus, you stay with us as an employee", I will be happy to accept that offer and then pay that additional amount of bonus for income tax...'

Q: You just mentioned if [the Employer] pays you the bonus, you will cease the action.

A: If [the Employer] pays me the bonus, I won't proceed for the action any more. No, I don't even need to go further on the High Court or proceed anything if they paid me the bonus. But in the end they didn't pay me any bonus.'

The Appellant's arguments on Sum A

31. During the hearing, the Appellant made the following arguments:

- (1) **First**, the entire Ex-gratia Payment in the amount of HK\$3.7 million was compensation for the Appellant's future career loss and for the settlement of her claims against the Appellant and subject to termination of her employment with the Employer. It was not paid as her bonus for 2016 or as past or future reward, as confirmed by the Employer. In supporting this argument, the Appellant made reference to the Employer's confirmation that the bonus pool of 2016 was smaller than that of 2015, and if the Sum A were included as calculation of bonus for 2016, her bonus entitlement for 2016 would have exceeded her bonus payment of 2015. The Appellant argued that there was 'no chance' that she could receive a total of HK\$2,100,000 as bonus for 2016;
- (2) **Second**, the Ex-gratia Payment made under the Termination Agreement would be subject to claw-back if the Appellant did not comply with the terms of the Termination Agreement, and the Ex-gratia Payment evidently did not represent bonus as bonus should not be subject to any claw-back. It was the Employer to decide each tranche of the Ex-gratia Payment arbitrarily as Sum A and Sum B, and it was only a coincidence that Sum A was of the same amount of her claim in the Labour Tribunal. The nature and purpose of Sum A was very different from what she claimed in the Labour Tribunal;
- (3) **Third**, the Ex-gratia Payment was made only after there was agreement for her employment to be terminated, and it therefore could not represent bonus as bonus is not payable during notice period of termination as per the Employment Contract; and

- (4) **Fourth**, the purpose of the Ex-gratia Payment was made in consideration of her agreement to surrender her legal rights against the Employer and was not related to any entitlement under the Employment Contract. As the Commissioner had accepted that Sum B was not taxable, Sum A should also be exempted as both Sum A and Sum B were of the same nature.

Applicable laws and principles for issues in Sum A

32. 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; ...’

33. 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...’*

34. 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.’

35. 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.’*

36. 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.'

37. 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.

Analysis of Sum A

38. 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.

39. In the circumstances, the nature of the Ex-gratia Payment or precisely Sum A will have to be examined closely in order to determine whether it was in substance a reward of past service. For instance, if Sum A was in substance an income from

employment (such as discretionary bonus or compensation of discretionary bonus entitlement), then regardless of whether it is labelled as something else (for example, an out of court settlement sum), it is still chargeable to salaries tax. Further, as the Commissioner submits and the majority of this Board accepts, 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.

40. It is not in dispute that the Employment Contract was not a fixed term contract. Either the Employer or the Appellant may terminate the Employment Contract with 3-month notice (or payment in lieu). It follows that it cannot be disputed that the Employment Contract can be lawfully terminated by the Termination Agreement, with 3-month termination notice given to the Appellant.

41. It is not in dispute that bonus was a major part of the Appellant’s income from the Employer for the assessment year of 2014/15 and 2015/16. In particular, the Appellant’s bonus for the year of 2015 (HK\$2,088,500) exceeded her base annual salary (HK\$1,850,000). Despite the Appellant’s contractual entitlement of bonus under the Employment Contract was stated to be entirely discretionary, and that the Appellant did not have the contractual entitlements to such bonus, it cannot be disputed an employee in the position of the Appellant would expect bonus to be paid by the Employer to her as a major part of her income in accordance with her past performance in that year, taking into account the performance of the Employer.

42. The above background explains the Appellant’s reaction against the Employer subsequent to the receipt of the Warning Letter resulting in a substantial reduction of her 2016 bonus to a mere HK\$392,000. First, the Appellant issued, through her solicitors, a demand letter to the Employer on 23 March 2017 demanding the withdrawal of the Warning Letter, readjustment of her performance ratings and recalculation of her discretionary bonus for year 2016. Second, when the Appellant’s demand was not met, on 6 July 2017 the Appellant commenced legal proceedings in the Labour Tribunal against the Employer for ‘*Unreasonable reduction of bonus for 2016*’ with claim amount of HK\$1,700,000. From the Appellant’s action, it cannot be disputed that the issue of the Warning Letter was a significant cause of the reduction of her bonus in 2016. In the Appellant’s own testimony at the hearing, the Appellant also agreed that but for the Warning Letter, the Appellant expected her 2016 bonus would be comparable to 2015, which was about HK\$2.08 million.

43. It therefore cannot be disputed that throughout February to July 2017, the central dispute between the Appellant and the Employer was whether the Warning Letter was unreasonably issued and should have been withdrawn, and the corresponding readjustment of the Appellant’s bonus. At the hearing, the Appellant fairly accepted that had the Appellant been paid at the time the HK\$1,700,000 before the case was transferred to the High Court, the Appellant would have ceased the legal action and she would accept it was part of her income chargeable to Salaries Tax. Although the Appellant added that if she were being paid the HK\$1,700,000 it could mean she could stay in the employment, it

cannot be disputed that the Employment Contract was always subject to termination by 3-month notice.

44. It must follow that had the Appellant been paid the Sum A before the legal action was transferred to the High Court, Sum A would be income chargeable to Salaries Tax regardless of whether subsequently the Appellant's employment were immediately terminated in accordance with the terms of the Employment Contract. Clearly in that case the Appellant would feel aggrieved and might commence fresh proceedings against the Employer for other causes of action, it could not escape from the fact that Sum A remained taxable in such circumstances.

45. The question is therefore, what had changed the nature and substance of Sum A. The Appellant argued that as it became apparent to her that the Employer was forcing her out and that she would have no future at the Employer, her claim was changed from '*correction of 2016 bonus*' to '*future career damage compensation*', and therefore she came up with the entire claim of HK\$3.7 million as compensation of 1-year earning. However, the Appellant's argument must be evaluated as whole with the facts and her testimony:

- (1) The Appellant claimed that the claim originally filed in the Labour Tribunal for claim of reduction of bonus was '*like a strategy than the real reason*' as '*the Labour Tribunal has a very limited scope on what they handle*'.
- (2) The Appellant's argument however is contradicted by the Appellant's own testimony that she did not dispute that up to the commencement of the legal action in Labour Tribunal, the Appellant would readily accept Sum A to be her bonus had the Employer paid that amount at the time.
- (3) It follows that the claim form initially filed in the Labour Tribunal for '*unreasonable reduction of bonus for 2016*' must represent a genuine claim of loss of bonus, instead of what the Appellant said to be an attempt to circumvent the jurisdictional hurdle in the Labour Tribunal. The bonus claim would be consistent with her demand from her solicitors' demand letter issued in March 2017. In any event, the Appellant was under legal advice at the time when she commenced action in the Labour Tribunal. It is incredible that her legal advisor would have advised her to commence an incorrect claim in the Labour Tribunal, making up a claim solely to fit into the Labour Tribunal's jurisdiction.
- (4) In any event, it was the Appellant's evidence that she knew the Employer had already requested the Appellant to resign as early as February 2017 and suggested her to take a redundancy package in March 2017 (see the Appellant's email to Ms E of the Employer dated 5 March 2020), ie before the Appellant commenced the legal

proceedings against the Employer in July 2017. It contradicts the Appellant's argument that she only changed the cause of action in the legal proceedings in July/ August 2017 only after learning the Employer was forcing her out.

- (5) The only plausible explanation is, therefore, the Appellant intended to amend her claim at or before the call-over hearing on 1 August 2017 in the Labour Tribunal by adding an additional claim in relation to her allegations of unfair treatment by the Employer (instead of substituting the existing claim of loss of bonus by the additional claim). This explanation is reinforced by the fact that the Appellant had never indicated she would abandon her original claim of loss of bonus in the sum of HK\$1,700,000 in the High Court Action, notwithstanding the Appellant had not filed a Statement of Claim.
- (6) For this reason, the majority of this Board does not accept the Appellant's argument that the entire HK\$3.7 million represents her claim of compensation of 1-year earning or future career damage compensation. While it is up to the Commissioner to accept that Sum B (HK\$2,000,000) is not chargeable to Salaries Tax which arguably represents the additional claim amount which the Appellant intended to proceed in the High Court Action, the Commissioner's stance cannot be taken as an acknowledgement that Sum A represents the same nature of payment as Sum B.
- (7) In any event, without having the claim particularised in a Statement of Claim, it is difficult to understand the precise causes of action the Appellant had as against the Employer and their legal basis, and the justification of the quantum, beyond what the Appellant had already claimed (for loss of bonus).

46. As the majority of the Board finds that the claim of HK\$1,700,000 represents a claim of reduction of bonus from the Appellant but not something else, the next question is what is the substance of settlement sum from the Employer paid to the Appellant of such claim? To answer this question, one must consider whether the Appellant was entitled to bonus payment at the first place and whether the purpose of the payment was in order for the employer to perform its obligations under the contract. If the answer is 'yes', then it must follow that the payment was income 'from' employment.

47. From the evidence, it is clear that the Appellant was entitled to a claim of bonus payment in question as a reward of her past service, either subjectively or objectively:

- (1) It has always been the Appellant's evidence that she believed she was entitled to the bonus payment in question. This is demonstrated by her solicitors' letter dated 23 March 2017 and her claim commenced in the Labour Tribunal. In her evidence, she also said she expected her bonus payment for 2016 to be comparable to that of 2015;

- (2) The Appellant's bonus entitlement has been provided in her Employment Contract. Although the Employer's obligation to pay bonus to the Appellant was stated to be entirely discretionary, as demonstrated in *Fuchs*, even though the Appellant may not have legal entitlement to a gratuity, the gratuity would still be chargeable if payment represents a reward from the employer of the Appellant's past service; and
- (3) The Appellant's entitlement to bonus payment, as shown in the evidence, had been consistently a major part of the Appellant's income.

48. In the majority opinion of this Board, nor would a denial of the Employer of the entitlement of the Appellant's bonus payment alter the substance of the payment (which was eventually made). Employers and employees from time to time have disputes over their entitlements in the course of their employment. As long as it can be shown that the disputed payment represents a claim of the employee's entitlement (for example, for past services), the purpose of the payment (even if it was disputed by the employer) must be in order for the employer to perform its obligations under the contract, as its obligations would have been discharged once the payment has been made (even if it was disputed). Here, the Appellant even accepted that had the HK\$1,700,000 been made after she commenced the legal action, the payment would represent her income which would be subject to Salaries Tax.

49. In the course of the hearing, the Appellant relies heavily on the confirmation from the Employer that the Ex-gratia Payment did not represent bonus payment, salary payment or reward but for the settlement of the High Court Action in accordance with the terms of the Termination Agreement. Having found that the substance of the payment of Sum A represents the Appellant's entitlement, it matters not that it might linguistically be acceptable also to refer to it as 'compensation for loss of office' or something similar (for example a settlement sum) by the Employer (*Fuchs*). In any event, the Commissioner has already accepted that part of the Ex-gratia Payment (ie Sum B) is excluded from the Appellant's assessable income, as Sum B could be interpreted as a settlement sum of the Appellant's other personal claims against the Employer which was '*something else*'.

50. The fact that under the Employment Contract bonus would not be payable if a termination notice has been served would also not alter the substance of the payment. The test is whether the payment was in substance a reward of past service made by the employer. An employer can always waive the restriction in the Employment Contract by remunerating the employee even though the employer is under no legal obligation to do so. This is similar to bonus payment which the employer is not under a contractual obligation to pay, nonetheless the payment would be subject to Salaries Tax.

51. For the purpose of completeness, the Board has also carefully reviewed the Termination Agreement from the perspective of whether the Appellant's rights had been 'abrogated'. Other than the settlement of the High Court Action (which had already been

taken into account by the Commissioner in excluding Sum B from the Appellant's assessable income in relation to the additional claim on top of loss of bonus), there is no other rights which the Appellant has abrogated other than a release of the Employer's liability (which has already been factored in the settlement). The Appellant's argument that the Ex-gratia Payment is subject to claw-back by the Employer is neither here nor there as there is no evidence that the Employer has exercised its right for the claw-back.

Conclusion on Sum A

52. In the circumstances, the majority of this Board upholds the Commissioner's Determination that Sum A was the Appellant's income from her employment with the Employer and therefore should be chargeable to Salaries Tax for the year of assessment 2017/18.

Whether the Legal Fees are deductibles

53. On the applicable law and principles on whether the Legal Fees were deductibles from the Appellant's income:

- (1) Section 12 of the Ordinance governs deduction under Salaries Tax which provides:

'(1) In ascertaining the net assessable income of a person for any year of assessment, there shall be deducted from the assessable income of that person – (a) all outgoings and expenses, other than expenses of a domestic or private nature and capital expenditure, wholly exclusively and necessarily incurred in the production of the assessable income;'

- (2) The expenses must be incurred by the very fact that the employee holds the office and has to perform its duties, and they must be incurred in the course of performance of those duties (Ricketts v. Colquhoun 10 TC 118);
- (3) The deductible expenses do not extend to those which the employee has to incur mainly because of circumstances which are personal to himself or are the result of his own volition (Ricketts v. Colquhoun 10 TC 118);
- (4) The test is not whether the employer imposes the expense but whether the duties cannot be performed without incurring the particular outlay (Brown v. Bullock 40 TC 1);
- (5) In Commissioner of Inland Revenue v. Robert P. Burns [1980] 1 HKTC 1181, the Hong Kong Court of Appeal considered that there was a distinction between expenses incurred in the production of assessable income and those incurred for the purpose of earning the

income, and disallowed the taxpayer's claim for deduction of legal expenses incurred in his appeal to have his disqualification order set aside.

54. The Appellant's evidence is that the Legal Fees were paid by the Appellant in relation to the Warning Letter and her subsequent claims/ actions against the Employer. The Appellant claimed that it was paid to defend her job security so as to continue earning her income from the Employer.

55. Having considered the legal principles, this Board rejects the Appellant's argument. It is clear that the Legal Fees were not incurred in the performance of the Appellant's job duties, and they were incurred because of circumstances personal to the Appellant (in her ongoing dispute with the Employer). Applying Robert P. Burns, it cannot be said that the Legal Fees were incurred by the Appellant in the production of her assessable income.

56. The Board therefore upholds the Commissioner's Determination that the Legal Fees were not deductible under Salaries Tax.

Sum C

57. Notwithstanding the Appellant was granted garden leave from 16 December 2017 to 28 February 2018 and the Appellant was not required to report to work during the garden leave period, it is undisputed that the Appellant remained in her employment with the Employer until 28 February 2018 and she was entitled to employee benefits during such period. The garden leave provision is also provided in the Employment Contract. It is up to the Employer's choice to serve a termination notice of employment and require the employee to remain as an employee until the expiry of the termination notice (albeit under a garden leave), and in that case the salaries the employee receives during the notice period would be her assessable income and chargeable to Salaries Tax (D80/03 18 IRBRD 820).

58. This Board therefore holds that Sum C is chargeable to the Appellant's Salaries Tax.

Section B: Dissenting Opinion of Member Ho Sai Man

59. I have the benefit of reading the draft of the Learned Chairman's decision.

60. After carefully considering the evidence and the law as pertinent to this case and the submissions on each side, with respect, I would beg to differ from the Learned Chairman's decision on Sum A (the ex-gratia payment of HK\$1.7 million). In my respectful view, the Commissioner has wrongly determined that Sum A is assessable income.

61. In delivering my opinion and decision here, unless otherwise defined below, I would respectfully adopt the abbreviations helpfully set out by the Learned Chairman above.

62. On the applicable laws and principles for considering whether Sum A is assessable, they are neatly summarized by the Learned Chairman at paragraphs 32 to 37 above which I would respectfully adopt.

Sum A was paid by Employer without recognizing Appellant being entitled to her 2016 bonus claim

63. In my view, in truth and in substance, Sum A was not paid by the Employer to settle the Appellant's claim as compensation for her claim of unreasonable reduction of her 2016 bonus initiated in the Labour Tribunal. Nor the Employer recognized or acknowledged Sum A to have anything to do with such bonus claim.

64. The ex-gratia payments comprising Sum A and Sum B totalling HK\$3.7 million was paid **pursuant to** the terms carefully crafted and embodied in a separation agreement dated 17/11/2017 entered into between the Appellant and the Employer (for itself and on behalf of each Group Company and their respective former and current officers, Position D, employees and agents) (**'the Settlement Agreement'**).

65. Importantly, the settlement terms do not say or suggest the payment of Sum A to the Appellant has anything to do with the Employer recognizing or acknowledging that it was ever obliged to pay any more 2016 bonus (as claimed by the Appellant), on top of the sum of HK\$392,000 paid to the Appellant earlier.

66. Rather, as can be seen from Clause 10.2, it was agreed between the parties that the High Court action should be disposed of by way of a dismissal:–

*'10.2 You agree to **dismiss** your claims in the High Court action with no order as to costs and you agreed to apply for a consent order in the terms attached at Schedule 3 for the dismissal of the High Court action...'*
(emphasis supplied)

67. The point to underscore here is that the agreed method of settlement is to have the High Court action³ dismissed, as opposed to the case of judgment being entered in respect of any part of the 2016 bonus claim asserted therein.

68. At the very least, the settlement terms entered into in the aforesaid manner could hardly suggest the Employer would in any way recognize or acknowledge Appellant had any merits in bringing the 2016 bonus claim against it in the first place.

Employer made it clear the ex-gratia payments (including Sum A) was not bonus, salary or reward

69. Although the Employer described the sum of HK\$3.7 million was paid to

³ The High Court action was originated from the Appellant's claim commenced at the Labour Tribunal for unreasonable reduction of 2016 bonus. For the Claim Form dated 6/7/2017, see Bundle B1, p.103.

the Appellant as ‘Terminal Award’ in its notification reported to the IRD for the particulars of income from 1/4/2017 to 28/2/2018 (Agreed Facts, paragraph 1(5)(a)), in their subsequent responses to the Assessor’s enquiries, the Employer corrected itself and clarified that such payment of HK\$3.7 million was a settlement payment and consideration for the Appellant’s acceptance and adherence to the Settlement Agreement. **It was not a bonus payment, salary payment, or reward to the Appellant.** (Agreed Facts, 1(12)(e))

Ex-gratia payments paid essentially to buy off Appellant’s unfair treatment claims/potential claims

70. Under the Settlement Agreement, apart from agreeing to the dismissal of the High Court Action, there are other material terms the Appellant also agreed to adhere to, which the Employer apparently used to buy off the risks of any adverse effect on the images or reputation of the Employer (or even to the entire Group to which the Employer belonged) which might be brought about by the other unfair treatment claims or potential claims the Appellant then pursued and/or threatened to pursue against the Employer.

71. Two clauses are particularly pertinent here to address these unfair treatment claims/potential claims.

72. First, according to clause 10.1 of the Settlement Agreement, the arrangement set out therein are in full and final settlement of, not only the High Court Action, but also,

*‘... **all claims and disputes arising out of or in connection with the High Court Action and all other claims, costs, demands, complaints, expenses and rights of action of any kind whatsoever or howsoever arising which you have now or may have at any time in the future against the Firm⁴ and/or against any Protected Person⁵ arising out of or in connection with your employment with the firm, including your holding of any office with the Firm or the cessation of such employment or office holding, and including, without limitation, any statutory or contractual entitlements you have or may have under Hong Kong law or any other applicable law. Nothing in this clause shall prohibit you (for yourself, heirs, executors, administrators, trustees, legal representatives, successors and assigns) from making any claim to enforce the terms or this Agreement.**’ (emphasis supplied)*

73. Second, clause 9.1 provides that:-

‘No Disparagement

9.1 You agreed that you will not, or will not induce any third party to, make any statement or comment, publish any statement, or issue any

⁴ ie referring to the Employer

⁵ ‘Protected Party’ is defined to mean each Group Company and their respective former and current officers, Position D, employees and agents under clause 14.

communication or publication, written or otherwise, to any third parties (including clients, employees and media, or any representative thereof) through any medium (including but not limited to print, television, radio, email, telephone and Internet) that disparages the name, reputation, practices or operations of any Protected Party.’ (emphasis supplied)

74. As pointed out in paragraph 64 above, the protection afforded by the aforesaid clauses is not limited to the Employer itself, but also extends to cover all the other companies within the Group to which the Employer belonged, and their respective staff. In contrast, the employment contract was entered into between the Appellant and the Employer only.

75. Putting it another way, the net position is that the ex-gratia payment (ie Sum A plus Sum B) was made in exchange for the Appellant’s promise to have her High Court action dismissed (without the Employer recognizing or acknowledging the viability of her 2016 bonus claim), and also for the *other purposes* requiring her not to pursue any further her claims and/or potential claims of unfair treatments as allegedly committed by the Employer against her, so as to protect the image and reputation of the Group as a whole (including the Employer). I shall return to these unfair treatment claims and/or potential claims for a more detailed discussion later.

76. From the business and commercial perspective, it is not difficult to conceive that the Employer or even the Group would be prepared to pay hefty sums to buy off the adverse risks (stemming from these unfair treatments claims and/or potential claims) which, if materialized, could seriously mar the goodwill and reputation of the entire Group (not just the Employer) even they might not see the Appellant’s 2016 bonus claim itself having any merits in the first place. As said, the Employer in its letter to the Commissioner (with receipt stamp chop of 9/1/2020) made it clear that the ex-gratia payment of HK\$3.7 million (including Sum A) was not a bonus payment, salary payment, or reward to the Appellant.

No objective evidence extrinsic to the Settlement Agreement to show the ex-gratia payment is assessable income either

77. The remaining question to ask is: is there any other sufficient evidence before the Commissioner or this Board to show that the Employer was obliged to exercise its discretion to pay the Appellant an extra HK\$1.7 million as she originally claimed in the Labour Tribunal in relation to her 2016 bonus.

78. After carefully surveying the evidence in their totality, I think the answer is also ‘No’.

79. In her Claim Form 2 filed with the Labour Tribunal, no breakdown nor calculation was provided to explain how the unreasonable reduction of bonus for 2016 of HK\$1.7 million was arrived.

80. Before the Commissioner and this Board, there was likewise no objective evidence to show how the Appellant would be entitled to claim an additional HK\$1.7

million (or any part thereof), on top of HK\$392,000 already paid by the Employer.

81. Under the employment contract, it is clearly provided that the payment of the bonus is at the sole discretion of the Employer, and Appellant has no contractual entitlement thereto.

82. Notwithstanding the Appellant's complaint that the final warning letter of 7/2/2017 was wrongly issued by the Employer and should be withdrawn, and the fact that discretionary bonuses of HK\$1,250,000 and HK\$2,088,500 were paid to the Appellant for 2014 and 2015 respectively, in the evidence the Appellant provided to the Labour Tribunal as made available to this Board, one cannot discern *at all*, what specific factors the Employer should and would otherwise have taken into account in the *proper* exercise of the discretion, such that the Appellant would more likely than not have received the additional amount of HK\$1.7 million (or any part thereof) for her 2016 bonus as she claimed.

83. In my view, the mere fact that Appellant subjectively believed or expected she was entitled to the bonus payment in question, without any objective evidence in support, does not suffice. Given the state and quality of the evidence before this Board, any suggestion that the Appellant would have received HK\$1.7 million more (or any part thereof) for her 2016 bonus remains a sheer speculation.

84. In fact, upon the Commissioner's request made in its letter dated 20/1/2020, the Employer provided a detailed response dated 7/5/2020 explaining what factors was taken into account by the Employer to arrive at the figure of HK\$392,000 for the Appellant's 2016 bonus, and why the 2016 bonus was substantially less than that for the preceding year. The Commissioner never suggested any part of the explanation given by the Employer (including the detailed reasons behind the issuance of the final written warning dated 9/2/2017, and the company's bonus pool for the 2016 performance year became smaller) should be faulted.

85. Importantly, by this appeal hearing, there was no evidence before this Board to effectively rebuke the Employer's earlier finding of the Appellant's submission of personal expenses as business expenses for reimbursement to support the legitimacy of the final written warning to her. (See: Agreed Facts, 1(3)). There was likewise nothing before the Commissioner or this Board to suggest that the Employer's finding or the final written warning was wrongly made or issued.

Background against which the 2016 bonus claim was instituted in Labour Tribunal & the unfair treatment claims

86. On the contrary, the Appellant testified at the appeal hearing (and whose evidence is unchallenged) that her original Labour Tribunal claim for unreasonable reduction of 2016 bonus was '*like a strategy than the real reason*' as '*the Labour Tribunal has a very limited scope on what they handle.*'

87. In this connection, as per the Appellant's testimony in the hearing:-

'Because my lawyer also told me "For the future career damage and the psychiatric injury and the sexual discrimination, all of those, actually the compensation amount would be far more than your past bonus. That's also the past bonus you could never get from Company B anyway, right."

Also, at that time, they also approach a barrister. So you know, it's not like Labour Tribunal. Labour Tribunal allow me to write a statement by myself. I don't need to use any lawyer. But for the High Court, I cannot write a plea by myself. I have to, I must to, I must hire a barrister, which is very expensive, to write the claim for me. So then that's why at that time, I haven't done it because that -- to write a plea already gonna be over 250,000. But then if that happen, we would totally change the whole -- I wouldn't say totally change; but I would change a lot of things from my Labour Tribunal claim.'

88. The following matters transpired at this appeal hearing do lend credence to the aforesaid testimony about the Appellant's real motive behind in bringing her Labour Tribunal claim:-

- (1) She produced a draft statement which she originally intended to submit to the Labour Tribunal⁶. But the final version she produced to the Tribunal, which was trimmed down a bit, included various other claims/complaints she made against the Employer as grouped under different headings as follows:-
 - (a) Unfair Treatment on My Sick Leave application
 - (b) Sex Discrimination from Daily Operation (such as client coverage, travel/expense policy) to Promotion and Compensation
 - (c) HR's Conspiracy on Constructive Dismissal and Allowing the Spread of Defamatory Rumor against her Employment.
 - (d) The Ties of Kinship at Work Led to Abusive Power and Inequality.
 - (e) Management & HR's Misconduct, Failure to Promote, Work Bullying and Retaliation.
- (2) After hearing the parties, this statement was ruled in by this Board despite it was submitted out of time and opposed by the IRD representative.

⁶ It was contained in a pdf attachment to the Appellant's email to the Board of Review dated 8/12/2020, and printed copies of the statement were provided to the Board for consideration at the hearing.

(2023-24) VOLUME 38 INLAND REVENUE BOARD OF REVIEW DECISIONS

(3) In the statement, the Appellant sought to substantiate with concrete details the various wrongs allegedly done to her by the Employer under each of the above headings, and pointing out the names of the various staff as involved in the alleged wrongful conducts.

(4) At the outset of her statement, it was also stated that:-

'I,, would like to file a claim against my employer, ..., for a series of unfair treatments, including sex discrimination, workplace bullying, retaliation/victimization, constructive dismissal trap and failure to promote, which have led to substantial financial loss, material career damage and psychiatric damage to me...'

(5) She testified before this Board that it was essentially owing to these unfair treatment claims she sought to introduce before the Labour Tribunal that her case was transferred to the Court of First Instance:

'... So, that is how the case being transferred to High Court. So without a statement to mention all of those detrimental treatment and grievance I go through, I don't think this case would be transferred to High Court, which is also evidence for what I just stated.'

89. Taking a fair and balanced view of the evidence the Appellant presented to Labour Tribunal, I think that it was actually these unfair treatments claims / potential claims (but not the 2016 bonus claim) that she considered to be really viable for seeking compensation against the Employer for the various alleged wrongs done to her, which were on the face of them either tortious or statutory in nature, or amounting to constructive dismissal.

90. Pausing here, it is important to appreciate that assuming if, and only if, any of these wrongs can be substantiated in Court, the Employer would be ordered to pay statutory compensation and/or common law damages to compensate the Appellant to redress the wrongs done to her in the course of her employment. In terms of the nature and purpose of such payment, these compensation and damages should not be treated as assessable income *'from employment'*.

91. In Henley v Murray [1950] 1 All ER 908 (which case was referred to in *Fuchs* (supra) at p.87), the judgment of Sir Raymond Evershed M.R. at 909E-G is instructive here:-

'There is another class of case where the bargain is of an essentially different character, viz, where the contract itself goes altogether and some sum becomes payable for the consideration of the total abandonment of all the contractual rights which the other party had under the contract. In the course of the argument an extreme case was put to counsel for the Crown of an employer who wrongfully breaks a contract of service and discharges a servant wholly therefrom and the servant then sues for damages for

wrongful dismissal. *Although, of course, it is true to say that the sum awarded as damages arises from the contract in the sense that if there had never been a contract the sum of damages could never have been awarded, counsel admitted that, in a case of that sort, it would be impossible to suggest that the sum awarded to the servant for damages was taxable under sched E.*' (emphasis supplied)

92. At p.911E-G, Somervell LJ echoed Evershed M.R's judgment by saying that:-

'I agree. It is conceded by the Crown that in a case where damages for wrongful dismissal are sued for, the sum awarded as damages is not only not within sched E but, also, is not taxable as income under any other schedule.

If in the case of dismissal where the employee says: "I am wrongfully dismissed," and sued for damages, he is admittedly outside sched E and untaxable, it seems to me to follow from that, if one goes by stages, that if one takes a case where equally the employer dismisses his employee and the damages are agreed without litigation, the fact that they are agreed instead of being awarded by a judge or jury cannot affect their legal position in regard to the income tax code. It seems to me on the evidence that that is what happened here. The employers said: "You must go." The appellant was forced into going at their request. The sum which he stipulated for must legally be in precisely the same position as would have been a sum for damages for wrongful dismissal.' (emphasis supplied)

93. Certainly, this Board needs not go into the merits of the allegations of unfair treatment claims / potential claims (as mentioned in paragraph 88(1) and (4) above) for the purpose of this appeal hearing, nor to consider whether they were indeed viable claims as per the Appellant's complaint.

94. In my personal view, the litigation tactics adopted by the Appellant (which she related to this Board at this hearing) should not really be approved of, for they have the appearance of misusing or abusing the Labour Tribunal proceedings as a mere springboard to invoke the legal process for achieving a better vantage point for negotiating compensation in relation to her unfair treatment claims with the Employer. But strictly speaking, that is a matter between the Employer and the Appellant.

Settlement of the unfair treatment claims is the essence of the bargain

95. What really matters here is that, viewed in their proper context and according to the background leading to the signing of the Settlement Agreement discussed above, these unfair treatment claims/potential claims would fit well into such parts of Clause 10.1⁷ providing for '*claims and disputes arising out of and in connection with the High*

⁷ See : paragraph 72 above

Court Action or *'all other claims... demands, complaints ...of any kind whatsoever or howsoever arising which [the Appellant] have now or may have at any time in future against the Firm and/or against any Protected Person arising out of or in connection with [the Appellant's] employment with the firm or the cessation of such employment or office...'* therefore constituting the proper subjects for settlement, for which the ex-gratia payments were paid.

96. In these circumstances, one would then readily appreciate that when the High Court action was provided to be settled under Clause 10.1, that would only constitute a subject for settlement, and the unfair treatment claims or potential claims would amount to other subjects of the settlement, which are in my view the essence of the bargain between the parties under the agreement.

97. Viewed thus, the mere fact of the ex-gratia payment (including Sum A) was paid to the Appellant would not necessarily imply the Employer's discharge of its obligation under the employment contract with respect of the 2016 bonus claim according to the terms of the settlement.

Construction of the Settlement Agreement

98. Ultimately, it is a matter of construction of the Settlement Agreement for ascertaining the parties' intention thereunder to determine whether any part of the ex-gratia payment paid to settle the High Court Action would be regarded as a payment to settle the 2016 bonus claim (or any part thereof). As pointed out above, it is not the case here.

99. First and foremost, there could hardly be any *meeting of minds* under the contract to go for such construction when we look at the background against which the Settlement Agreement was entered into.

100. All along, the Employer had maintained that the Appellant was not entitled to such claim on the evidence before Commissioner and this Board. Naturally, the Employer and its lawyer would be very cautious in not acknowledging the payment as such, when it comes to the drafting of the Settlement Agreement, for they would otherwise be seen as indirectly admitting wrongs on the Employer's part in unreasonably and unjustifiably reducing the Appellant's 2016 bonus, and this would in turn lend legitimacy to the Appellant's unfair treatment claims.

101. Looking from the Appellant's perspective, at the time of entering into the Settlement Agreement, realistically speaking, she would no longer be bothered by how the Employer would perceive and treat her 2016 bonus claim thereunder, so long as she would receive an acceptable ex-gratia payment to settle her unfair treatment claims/potential claims (which according to her testimony given to this Board are where her real grievance lies), and to have a clean break separation with her Employer thereafter.

102. In fact, under the settlement terms, before the Appellant received Sum A (as the first tranche of the ex-gratia payment) from the Employer, she had already agreed to have her 2016 bonus claim under the High Court Action dismissed, and by doing so, in my

view, she would all practical purposes, be treated under the contract as effectively abandoned her 2016 bonus claim as part of the settlement package.

103. Therefore, upon the proper construction of the settlement agreement as a whole, by the time when the agreement was entered into, the Appellant need not and should not be construed as still asserting her 2016 bonus claim in order to have any ex-gratia payment made to settle such claim, but rather she had effectively abandoned the same according to the settlement scheme as provided in the separation agreement.

104. In the light of the above analysis, any portion of the ex-gratia payment paid in settlement of the High Court action (but not paid in settlement of the 2016 bonus claim) therefore cannot be fairly and reasonably regarded as income from employment as so determined by the Commissioner according to the legal test laid down in Fuchs.

105. Lastly, for completeness sake, there are three further points that I should dispose of before I come to my final conclusion:-

- (1) First, the fact that it so happens that Sum A is of the same amount as the unreasonable reduction of 2016 bonus initially claimed by the Appellant is neither here nor there in light of the above analysis. Especially, the Employer made it clear that the entire ex-gratia payment (including Sum A) was not bonus, salary or reward to the Appellant. This matter was put beyond doubt by the Employer's reply letter to the Commissioner dated 7/5/2020 saying that '*the split was arbitrary and the first tranche did not represent a bonus payment.*'
- (2) Second, in the Commissioner representative's closing submissions (paragraph 7.7(h)), it is said that the Commissioner made an apportionment accepting that part of the ex-gratia payment (ie Sum B) was paid as compensation for the Appellant's claim for detrimental treatments or psychiatric injury. But with respect, this reasoning / argument is illogical since it **presupposed** *some* portion of the ex-gratia payment of HK\$3.7 million was paid to settle the 2016 bonus claim. But the very purpose of the subject exercise is to find out whether this was indeed so, but not assuming it was so and to carry out a purported apportionment. Given the above analysis, there is actually no effective or valid evidence to support such finding, nor by the reasonable construction of the Settlement Agreement.
- (3) Third, at paragraph 7.4(c) of his closing submissions, the Commissioner's representative submitted to the effect that the ex-gratia payment of HK\$3.7 million was paid in full and final settlement of, apart from the High Court Action, also the employment and any statutory and contractual entitlements by citing Clause 10.1 of the Settlement Agreement.

- (4) However, when Clause 10.1 is reasonably construed in its proper context, ‘**any** statutory or contractual entitlements’ is only meant to be a sweeping phrase affording comprehensive protection to the Employer, but it does not necessarily mean there **really existed** such other statutory or contractual entitlements, let alone the 2016 bonus claim would amount to a ‘statutory or contractual claim as caught by such phrase.
- (5) In this connection, it is noteworthy that paragraph 2 of the Settlement Agreement has provided a list of compensation and the employee benefits that the Appellant would be entitled to (including the MPF benefits, untaken annual leave pay, medical and life insurance benefits, etc.), sub-paragraph 2.9 specifically provided that ‘*[s]ave as set out in this Agreement, you shall have no entitlement to any other payment or benefit from the Firm, whether by way of wages, bonus or otherwise.*’, and paragraph 3 provided for her deferred and equity-based compensation. In Schedule 1 to the Settlement Agreement (which set out the final payments), apart from the two tranches of ex-gratia payments abovementioned, it also provided the calculation of some employment benefits of the Appellant amounting to HK\$177,493.13.
- (6) Viewed thus, even **if** there really existed any other statutory or contractual entitlement(s) which have not yet provided for in the Settlement Agreement, the last bit of clause 10.1 – ‘*any statutory or contractual entitlement*’ – would be wide enough to preclude the Appellant from making any further claim for such other entitlements from the Employer in future.
- (7) As such, it is also plain that the 2016 bonus claim cannot amount to such contractual entitlement. Especially, the earlier part of Clause 10.1 has already provided for the settlement of the High Court Action – ‘*[y]ou accept and confirm that the arrangements set out in this Agreement are in full and final settlement of the High Court Action,...*’. And the detailed discussion of the construction of such part of clause 10.1 in relation to the settlement of the High Court Action already explained why the settlement of the action in accordance with the agreement does not necessarily mean that the ex-gratia payment was made to settle the 2016 bonus claim. (See : paragraphs 98 to 104 above)
- (8) In the premises, the Commissioner could not and did not appear to have based his determination by making any reference to these *other* statutory or contractual entitlements, when he did not even know what these entitlements would be, let alone making any meaningful apportionment for the same out of the ex-gratia payment of HK\$3.7 million.

Application of the legal principles to Sum A

106. To conclude, by applying the relevant legal principles, in particular, those laid down by the CFA in Fuchs case, I come to the clear views that:-

- (1) Without any recognition or acknowledgement from the Employer that the Appellant was so entitled, the Appellant's claim for the unreasonable reduction of 2016 bonus remains a sheer claim (from its birth to death) on the evidence before the Commissioner and this Board. As such, no part of the ex-gratia payment of HK\$3.7 million can fairly and legitimately be regarded as a reward (as attributable to such bonus claim) for past services of the Appellant, or in return for her acting as or being an employee.
- (2) There are other legitimate purposes provided under the Settlement Agreement, including the purpose of securing the Appellant's assurance that she would not disseminate information to disparage the Group (including the Employer) and their staff, and that she would not pursue further the unfair treatment claims/potential claims against the Employer and the entire Group, in exchange for the ex-gratia payments, to prevent the adverse effect and repercussion these claims and/or potential claims might bring to the Group (including the Employer). This is the real and essential bargain of the ex-gratia payment of HK\$3.7 million (including Sum A).
- (3) The fact that the 2016 bonus claim initiated in the Labour Tribunal was transferred to the Court of First Instance owing to the Appellant's subsequent introduction of her unfair treatments claims/complaints against the Employer are material background circumstances, that should be taken into account to construe the Settlement Agreement which provided for a clean break separation between the parties by fully and finally settling their disputes and the legal action at the termination of the Appellant's employment.
- (4) Therefore, the entire ex-gratia payment of HK\$3.7 million (including Sum A) was essentially paid to the Appellant under the Settlement Agreement in exchange for her agreeing to settle the unfair treatment claims / potential claims and the High Court Action (but not her 2016 bonus claim), and therefore not recognizing or acknowledging any legitimacy of her 2016 bonus claim to constitute any possible reward for her past services, nor in return for her acting or being as an employee, to be regarded in substance as income from employment.
- (5) Hence, when the evidence is considered as a whole, the Commissioner cannot legitimately come to the determination that the ex-gratia payment of HK\$1.7 million (Sum A) received by Appellant

falls under the definition of taxable income under Section 8(1) and Section 9(1)(a) of the Inland Revenue Ordinance.

107. Due to the above reasons, I am satisfied that the Appellant has discharged her onus in proving that the Commissioner's assessment on Sum A is incorrect, and the appeal to that extent should be allowed.

108. As to the legal expenses, the Appellant fairly accepted at page 5 of her Opening Submission that should this Board find that Sum A is not assessable income, then her claim for the deduction of her legal expenses would no longer hold good.

109. However, if I was wrong, and that Sum A should actually be assessable as determined by the Commissioner for whatever reason, then I would agree that the legal expenses are not deductible expenses as contended by the Appellant.

110. Lastly, in relation to Sum C for the amount of HK\$500,001 I respectfully agree with the Learned Chairman that the appeal for that particular sum should be dismissed.

Section C: Conclusion

111. For the aforesaid reasons, by way of majority, the Appellant's appeal is dismissed.