

Case No. D6/23

Salaries tax – whether sum made to an employee upon termination of employment was taxable or not – payment was ‘from the employment’ or ‘for loss of office’ – sections 8(1), 9(1)(a), 68(4) of the Inland Revenue Ordinance (the ‘IRO’)

Panel: Loh Lai Ping Phillis (chairman), Fok Bryan and Ling Yee Nam Ebony.

Dates of hearing: 2 March 2023 & 5 May 2023.

Date of decision: 7 July 2023.

This was the Appeal of the Appellant/Taxpayer against the Deputy Commissioner of Inland Revenue Department (‘IRD’) determination dated 8 November 2022 (‘Determination’) regarding the Taxpayer’s objection to the Salaries Tax Assessment for the year of assessment 2019/20 raised on the Appellant.

The issue before the Board was whether the following three sums received by the Taxpayer upon termination of his employment should be chargeable to salaries tax: a severance payment of \$8,819,157 (‘Sum A’); and the gains realised by the Taxpayer by the acceleration and full vesting of his restricted share units (‘RSUs’) in the sum of \$1,978,112 (‘Sum B’) and performance stock units (‘PSUs’) in the sum of \$2,746,943 (‘Sum C’).

The Taxpayer was first employed by Company A (formerly known as Company B and Company C), an indirect subsidiary of Company F as Position G Division M and Position L. His employment was renewed for a fixed term of 3 years from 1 December 2016 to 30 November 2019 pursuant to a letter dated 5 September 2016 (‘Employment Contract’). The Employment Contract contained, *inter alia*, restrictive covenants including non-competition and non-solicitation during the term of employment and within 12 months after termination, and non-disclosure of confidential information.

Company F operated a 2013 Long Term Incentive Plan (‘LTIP’), under which awards in the form of RSUs, performance awards, dividend equivalents (‘DEUs’) or other awards were granted to certain employees, directors and other service providers as an additional incentive for them to make contributions to the financial success of Company F.

On XX December 2017, Company F entered into a merger agreement with Company J for Company J to acquire certain businesses of Company F (‘the Acquisition’). Upon completion of the Acquisition, Company F shares were exchanged to Company J shares in accordance with a conversion formula. As such, all the Taxpayer’s RSUs and PSUs under LTIP, and the DEUs granted to him over the years, were converted into Company J RSUs.

There was no discussion or negotiation on quantum of any sort between

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Company A and the affected employees. It was not necessary for the terminated employees to negotiate quantum, because the XX Month 2019 Company F's email to its employees, including the Taxpayer (the 'Severance Plan') was of global application to all soon-to-be-laid-off employees, designed and based on formulae to provide sufficient financial protection and to make them go away quickly and quietly.

By a letter dated 1 November 2019 ('Termination Letter'), Company A gave one month's notice to the Taxpayer that his employment with Company A would be terminated on 30 November 2019. Following termination, the Taxpayer received Sum A and awards realised from the accelerated and full vesting of his RSUs and PSUs under the LTIP. The Termination Letter specifically referred to Sum A payment as 'compensation for loss of office'.

The Deputy Commissioner concluded in the Determination that Sum A was not a compensation payment for loss of employment (as argued by the Taxpayer), and Sum B and Sum C were paid in accordance with the Taxpayer's employment contract with Company A and derived from his employment. They should thus all be chargeable to salaries tax. Having regard to the fact that the Taxpayer's position was made redundant, the Assessor's proposed allowance for an amount equivalent to the Taxpayer's annual base salary, less the statutory severance payment of \$90,000, to be excluded out of Sum A from the assessable income was adopted (the 'Severance Payment' was equivalent to \$90,000 plus Sum A). The Assessor's proposed revision of total assessable income and tax payable thereon at was affirmed by the Deputy Commissioner.

Held:

1. In determining whether a sum is an income from employment, one has to ascertain the true nature of the sum and the circumstances giving rise to it. A sum made to an employee upon termination of employment does not necessarily follow that it is not chargeable to Salaries Tax. The sum is taxable if it is paid to an employee (a) in return for acting as or being an employee; (b) as a reward for past services; or (c) as an inducement to enter into employment. The sum is not taxable only if it is not paid under any of those 3 conditions ('for something else'). (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74; Commissioner of Inland Revenue v Poon Cho Ming John (2019) 22 HKCFAR 344; and Heath Brian Zarin v Commissioner of Inland Revenue [2021] HKCFI 1846 applied).
2. A contractual lump sum paid upon termination of employment might be apportioned into taxable and non-taxable parts. The portion paid to the taxpayer as inducement to enter into employment was taxable. Only that portion paid to the taxpayer as consideration for the restrictive covenant was held non-taxable. A payment could be 'from the employment' even though there might be other reasons for it. (Commissioner of Inland Revenue v Yung Tse Kwong [2004] 3 HKLRD 192; and Kuehne + Nagel Drinks Logistics Ltd v Revenue and Customs Commissioners [2012] STC

840 followed).

3. Sum A was not an inducement or motivation for future services, nor as a reward for past services. The nature and purposes of Sum A were different from those of the performance bonus paid for past good services, and the retention bonus paid for motivation purposes, for which the Taxpayer had paid tax. The Taxpayer's right to payment of Sum A was contingent on him providing the waiver and release, giving up his legal rights to all or any potential claims, past present or future, known or not known. It was a payment made pursuant to the generous global Severance Plan in the mass layoffs situation, aiming at providing sufficient or appropriate financial protection to those employees being laid off and making them go away quickly and quietly.
4. There was no requirement of negotiation on quantum of the termination payments to render them non-taxable, or evidence of threats of legal actions or actual legal actions having been taken. The legal test as shown in the leading authorities Fuchs, Poon and Zarin remained the substance and real purpose of the payments. The entitlement to Sum A payment was not provided anywhere in the Employment Contract, based on which the Taxpayer would not have any right to sue or enforce payment, like the situations in Poon and Zarin in which the payments were found not 'from the employment' and not taxable. The Board concluded that Sum A, as stated in the Termination Letter, was a severance payment made upon redundancy resulted from the Acquisition, and as compensation for loss of office, the associated hardship and acceptance of the terms stated therein. (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74; Commissioner of Inland Revenue v Poon Cho Ming John (2019) 22 HKCFAR 344; and Heath Brian Zarin v Commissioner of Inland Revenue [2021] HKCFI 1846 followed)
5. Sum B and Sum C paid to the Taxpayer formed part of his employment package. They were not part of the termination package, nor originated from the termination at Company A's discretion. Payment of Sum B and Sum C was not mentioned in the Termination Letter, and was automatic, to which Company A did not have any discretion. The Board found that Sum B and Sum C were in substance and in truth the Taxpayer's entitlements and payments 'from the employment' and for incentive purpose under the LTIP, hence should be chargeable to salaries tax.
6. The Appeal was allowed to the extent that the whole of Sum A in the sum of \$8,819,157, ie the Severance Payment less the statutory severance payment of \$90,000, should not be chargeable to salaries tax. The Deputy Commissioner's decision in his Determination was confirmed that the whole of Sum B and Sum C should be chargeable to salaries tax.

Appeal is allowed in part.

Cases referred to:

Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74
Henley v Murray (1950) 31 TC 351
Commissioner of Inland Revenue v Poon Cho Ming John (2019) 22 HKCFAR
344
Heath Brian Zarin v Commissioner of Inland Revenue [2021] HKCFI 1846
Commissioner of Inland Revenue v Yung Tse Kwong [2004] 3 HKLRD 192
Kuehne + Nagel Drinks Logistics Ltd v Revenue and Customs Commissioners
[2012] STC 840

Appellant in person.

Julian Lam, instructed by the Department of Justice, for the Commissioner of Inland Revenue

Decision:

A. Introduction

1. This is the Appeal of the Appellant/Taxpayer against the Determination of the Deputy Commissioner of Inland Revenue Department (**‘IRD’**) dated 8 November 2022 (**‘Determination’**) regarding the Taxpayer’s objection to the Salaries Tax Assessment for the year of assessment 2019/20 raised on the Appellant.

2. The employment of the Taxpayer by Company A (formerly known as Company B and Company C) was terminated on 30 November 2019.

3. The issue before the Board is whether the following three sums received by the Taxpayer upon termination of his employment should be chargeable to salaries tax: a severance payment of \$8,819,157 (**‘Sum A’**); and the gains realised by the Taxpayer by the acceleration and full vesting of his restricted share units (**‘RSUs’**) in the sum of \$1,978,112 (**‘Sum B’**) and performance stock units (**‘PSUs’**) in the sum of \$2,746,943 (**‘Sum C’**).

4. The Deputy Commissioner concluded in the Determination that Sum A was not a compensation payment for loss of employment (as argued by the Taxpayer), and Sum B and Sum C were paid in accordance with the Taxpayer’s employment contract with Company A and derived from his employment. They should thus all be chargeable to salaries tax. Having regard to the fact that the Taxpayer’s position was made redundant, the Assessor’s proposed allowance for an amount equivalent to the Taxpayer’s annual base salary, less the statutory severance payment of \$90,000, ie $(\$371,530 + \$51,850) \times 12 - \$90,000 = \$4,990,560$ to be excluded out of Sum A from the assessable income was adopted. The Assessor’s proposed revision of total assessable income of \$15,680,670 and tax payable thereon at \$2,332,100 was affirmed by the Deputy Commissioner.

5. This Board held the hearing of this Appeal on 2 March and 5 May 2023.
6. The Taxpayer had no representation and acted in person.
7. The Commissioner was represented by Counsel Julian Lam and Vivian Kao.
8. Both referred to documents submitted and correspondence exchanged on the issues before this Board.
9. The Taxpayer gave oral evidence.
10. He has adduced in evidence a witness statement dated 3 February 2023 from Ms D, Position E of Company A regarding the provision by IRD of an advance ruling as follows: Severance payments made to employees of Company A being made redundant in Hong Kong would not be assessable to salaries tax (**‘the Advance Ruling’**); but the Advance Ruling is not applicable to executives who were employed under fixed-term contracts (such as the Taxpayer). Ms D’s evidence is agreed by the Commissioner, and she was not called to give evidence by the Taxpayer or for cross-examination.
11. The Commissioner called two witnesses Ms Rita Yun (Assessor) (**‘Yun’**) and Ms Carmen Chan (Senior Assessor)(**‘C Chan’**) in reply to the Taxpayer’s evidence that he was given to understand by these officers of IRD during previous telephone communications that the severance payment Sum A could be excluded from assessable income.

B. The Taxpayer’s Grounds of Appeal

12. In his Notice and Statement of Grounds of Appeal dated 30 November 2022, the Taxpayer raised the following grounds of appeal against the Determination:
 - (1) The entirety of the severance payment/Sum A is a payment for loss of office, wholly unrelated to any past services during employment or any inducement to provide future services, and therefore is not chargeable to salaries tax; and
 - (2) The awards of Sum B and Sum C received at the time of termination upon full vesting of the remaining outstanding RSUs and PSUs were made possible only when full vesting was accelerated solely due to the redundancy/ Taxpayer’s loss of office, therefore are also not chargeable to salaries tax.

C. Facts & Key Events

13. The facts and key events are not disputed and are supported by documentary evidence.

C1. *The Taxpayer’s Employment*

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14. The Taxpayer was first employed¹ by Company A, an indirect subsidiary of Company F as Position G Division M and Position L, FIC Asia for a term of 3 years from 1 December 2013 to 30 November 2016.

15. He was promoted to Position H and Position L – Division M for the Company C Group, Asia Pacific & the Middle East in the Department N (**‘Position H’**) with effect from 1 July 2016.

16. His employment was renewed for a fixed term of 3 years from 1 December 2016 to 30 November 2019 pursuant to a letter dated 5 September 2016² (**‘Employment Contract’**).

17. The relevant terms of the Employment Contract are described in full in paragraph 1(4) of the Determination. It is not necessary to repeat the details here for the purposes of this appeal.

18. The Employment Contract contains, *inter alia*, in paragraph 22 and 23 restrictive covenants including non-competition and non-solicitation during the term of employment and within 12 months after termination, and non-disclosure of confidential information.

19. The Taxpayer’s employment was terminated on 30 November 2019 in the circumstances detailed in Sub-sections C4 to C6 below.

C2. The Long Term Incentive Plan

20. Company F operated a 2013 Long Term Incentive Plan (**‘LTIP’**), under which awards in the form of RSUs, performance awards, dividend equivalents (**‘DEUs’**) or other awards were granted to certain employees, directors and other service providers as an additional incentive for them to make contributions to the financial success of Company F.

21. The LTIP contains, among other things, the following provisions³:

- (a) The compensation committee of LTIP should have the authority to amend the terms of any outstanding award or waive any conditions or restrictions applicable to any award, provided that no amendment should materially impair the rights of the participant without the participant’s consent.
- (b) The compensation committee should determine and set forth in an agreement the terms and conditions of each award.

¹ Old employment contract (11-10-2013)

² Signed by the Taxpayer on 28-9-2016

³ LTIP Section 1.3, Article X

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- (c) The LTIP might be terminated and might be altered, amended, suspended or terminated at any time, in whole or in part, provided that no alternation or amendment would be effective without stockholder approval. No termination or amendment might, without the consent of the participant, materially adversely affect the rights of the participant.

RSUs

- (d) The compensation committee might from time to time grant RSUs on the terms and conditions set forth in the LTIP and on such other terms and conditions as were not inconsistent with the purposes and provisions of the LTIP as the compensation committee, in its discretion, might from time to time determine. Each RSU awarded to a participant should correspond to one share of common stock of Company F. Each agreement covering a grant of RSUs should specify the number of RSUs granted, the vesting schedule for such RSUs and any performance goals and any other terms that the compensation committee deemed appropriate.
- (e) On the date on which RSUs vested, the RSUs would be payable in cash equal to the fair market value of Company F shares or in shares or in a combination of cash or shares.
- (f) The compensation committee should determine and specify in the award agreement (or any employment agreement applicable to the participant) the impact of the participant's termination of service with Company F or any of its affiliates (referred to as '**the Company F Group**' collectively) on his unvested RSUs. Such provisions needed not be uniform among all RSU awards and might reflect distinctions based on the reasons for termination of service.

Performance awards

- (g) The compensation committee might from time to time grant performance awards consisting of performance shares or performance units (collectively PSUs) on the terms and conditions set forth in the LTIP and on such other terms and conditions as were not inconsistent with the purposes and provisions of the LTIP, as the compensation committee, in its discretion, might from time to time determine.
- (h) In the event that, during any performance period, any merger, acquisition or other similar corporate transaction or event, or any other extraordinary event or circumstances occurred, the compensation committee, in its sole and absolute discretion, might adjust or modify the calculation of the performance goals, to the

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extent necessary to prevent reduction or enlargement of the participant's awards under the LTIP.

DEUs

- (i) The recipient of RSUs and/or PSUs might, if so determined by the compensation committee, be entitled to receive interest or dividends or DEUs, with respect to the number of Company F shares covered by the related award.

22. Clause 4 of the Employment Contract provides that '*subject to prevailing policy*', during the annual eligibility review the Taxpayer would be nominated for the LTIP '*that may be in force from time to time*'.

C3. ***The Taxpayer's PSUs and RSUs entitlement/The Company J Acquisition***

23. On 29 September 2017, the Taxpayer was awarded 5,870 PSUs ('**the PSU Award**') under the LTIP. The terms and conditions of the PSU Award were set forth in a relevant Performance Stock Unit Terms and Conditions Notice for the FY2018 - FY2020 Performance Period ('**the PSU Notice**').

24. The PSU Notice contains, among other things, the following terms and conditions:

- (a) The PSUs would convert to Company F shares on 15 August 2020 ('**the PSU Vesting Date**') after the end of the three-year performance period from 1 July 2017 to 30 June 2020 ('**the Performance Period**').
- (b) The participant was entitled to receive DEUs for each regular cash dividend paid on Company F shares during the Performance Period. The DEUs should be subject to the same terms and conditions which applied to the PSUs and would convert to Company F shares on the date on which the PSUs vested.
- (c) The participant's eligibility to receive Company F shares was subject to the condition that he remained employed by Company F Group from the date of award to the date on which the PSUs were paid out in Company F shares.
- (d) In the event that the participant's employment was terminated for any reason during the Performance Period or after the Performance Period and before the payout of the PSUs, the participant should forfeit the PSU Award and should not be entitled to receive any payment thereunder.

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- (e) In the event that the participant's employment was terminated by reason of redundancy, he would be eligible to receive Company F shares on the PSU Vesting Date after the end of the Performance Period pro-rated based on the number of days he was employed by the Company F Group during the Performance Period.

25. On 13 December 2017, Company F entered into a merger agreement with Company J for Company J to acquire certain businesses of Company F (**'the Acquisition'**). In connection therewith the terms of the PSU Award were amended on 20 February 2018 as follows:

- (i) Following the completion of the Acquisition, all references in the PSU Notice to Company F should refer to Company J or the applicable successor entity (referred to as **'the Company J Group'** collectively) and all references to the participant's employment by Company F should refer to the employment by the Company J Group.
- (ii) The PSUs would be converted into RSUs of the Company J Group (**'Company J RSUs'**) and Company J RSUs would continue to vest subject to the participant's continued employment with the Company J Group and might be settled either in stock or in cash.
- (iii) In the event of termination of the participant's employment at any time following the completion of the Acquisition by the participant for good reason or by the Company J Group other than due to a termination for cause or as a result of death or permanent disability, the Company J RSUs would fully vest on the date of the termination and the participant would receive shares of common stock of the Company J Group (**'Company J Shares'**) on the PSU Vesting Date.

26. On 28 September 2018, the Taxpayer was awarded 3,664 RSUs (**'the RSU Award'**) under the LTIP. The terms and conditions of the RSU Award were set forth in the Restricted Share Unit Terms and Conditions Notice FY2019 - FY2021 Performance Period (**'the RSU Notice'**).

27. The RSU Notice contained, among other things, the following terms and conditions:

- (a) The RSUs would convert to Company F shares and would vest on 15 August 2021 (**'the RSU Vesting Date'**).
- (b) The participant was entitled to receive DEUs for each regular cash dividend paid on Company F shares during the period from the date of grant to the day immediately preceding the RSU Vesting Date. The DEUs should be subject to the same terms and conditions which applied to the RSUs.

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- (c) The participant's eligibility to receive Company F shares was subject to the condition that he remained employed by the Company F Group from the date of grant to the date on which the RSUs were paid out in Company F shares.
- (d) In the event that the participant's employment was terminated for any reason before the payout of the RSUs, the participant should forfeit all of his outstanding and unvested RSUs and should not be entitled to receive any payment with respect to the RSUs.
- (e) In the event that the participant's employment was terminated by reason of redundancy, a pro-rated number of his outstanding RSUs, based on the number of days he was employed by the Company F Group from 1 July 2018 to 30 June 2021, would vest on the date of his termination of employment.
- (f) The effects of the completion of the Acquisition on the participant's RSUs were as follows:
 - (i) All references in the RSU Notice to Company F should refer to the Company J Group, all references to Company F shares should refer to Company J Shares and all references to the employment by Company F should refer to the employment by the Company J Group.
 - (ii) The RSUs would be converted into Company J RSUs if the participant's employment transferred to the Company J Group. The Company J RSUs would continue to vest subject to the participant's continued employment with the Company J Group and might be settled either in stock or in cash.
 - (iii) In the event that the participant's employment was terminated within two years following the completion of the Acquisition by the Company J Group other than due to a termination for cause or as a result of death or permanent disability, the RSUs would fully vest on the date of the termination of employment.

C4. ***The Global Severance Plan***

28. The Acquisition had formally commenced in late 2017 as shown in a merger agreement dated 13 December 2017. On XX Month 2019, Company F sent an email to its employees (including the Taxpayer), with the subject '*Important Information about Severance*' ('**XX Month Email**'), which states, *inter alia*:

'As we enter the home stretch of our Company J transaction, we wanted to provide you with an update on severance.'

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We continue to be excited about the opportunities ahead for our businesses and our colleagues. However, we have ensured that there is appropriate financial protection in the event that Company J provides you notice of termination or terminates your employment in the year following the closing of the transaction.

We have worked closely with Company J to specify the severance terms outlined in the Merger Agreement and related documents into a legally binding Severance Plan in which all US non-union employees joining Company J are eligible to participate. ...

*Employees outside the US will be eligible to receive severance benefits with commercial terms that have at least the same value as those provided under the US severance plan [**Severance Plan**]. ...'*

29. Further information on the Severance Plan was provided by Company A to IRD in a letter dated 12 August 2021 in reply to enquiries made by the Assessor by letter:

'In March 2019, Company J acquired Company F including Company A. As part of the global acquisition, there was an undertaking made by Company F management at the head office to the legacy Company F employees that if their positions were terminated as a result of the acquisition by Company J within a set period of time, initially within 12 months from the date of the acquisition, they would be entitled to a severance payment in accordance with a certain formula.'

30. Company A explained the amounts and calculations of severance payments by way of an accompanying FAQ (**Severance FAQ**) under the heading '3. How much severance will I be offered?'. The severance pay would be the greatest of the following 3 bases of calculations:

•Employment agreement: The compensation (including base salary and target bonus) payable under your fixed term employment agreement from your termination date through the expiration of the term of the agreement

•Tenure: Four weeks of severance (sum of annual base salary and target bonus) for each year of service, up to a maximum of 24 months [ie a max of 2 years' severance pay]

•Title: Payments based upon the title of the employee, as follows:

Manager or Other positions: 0.5 times annual base salary

Director or equivalent: 0.75 times annual base salary

VP or equivalent: 1.0 times annual base salary

Position G or equivalent: 1.25 times the sum of annual base salary and average annual bonus

Position H or above: 1.5 times the sum of annual base salary and average annual bonus'

(‘3-Tier Methodology’)

31. There is no question that in the Taxpayer’s case, severance was greatest under the ‘Title’ methodology in the Severance Plan based on his title of Position H, being 1.5 x his annual base salary and average annual bonus. That was what he was paid for severance eventually.

C5. *Completion of Acquisition/Conversion of the PSUs and RSUs*

32. The Acquisition was completed on XX Month 2019 and Company A was acquired by Company J.⁴

33. Company A explained⁵ in response to the IRD’s enquiries that, following completion of the Acquisition, Company F shares were exchanged to Company J shares in accordance with the conversion formula: one Company F share = 0.4517 Company J share. As such, all the Taxpayer’s RSUs and PSUs under LTIP, and the DEUs granted to him over the years, were converted into Company J RSUs as follows:

- (1) 3,664 RSUs and 14 DEUs (totalling 3,678 share units) were converted into 1,662 Company J RSUs; and
- (2) 5,870 PSUs and 89 DEUs (totalling 5,959 share units) were converted into 2,692 Company J RSUs.

C6. *Termination of Employment*

34. By a letter dated 1 November 2019 (**‘Termination Letter’**), Company A gave one month’s notice to the Taxpayer that his employment with Company A would be terminated on 30 November 2019 (**‘Separation Date’**). It is stated in the preamble that as a result of the Acquisition, the Taxpayer’s position would *become redundant* and would *be eliminated*, therefore his employment with the Employer would end.

35. The Termination Letter was attached with a Deed of Undertaking made on 1 November 2019 and signed by the Taxpayer in favour of Company A (**‘the Deed’**) and a breakdown of the Taxpayer’s final payment.

36. The Termination Letter contains, *inter alia*, terms and conditions of payment of the following:

- (1) Full pay up of pro-rated bonus, remaining retention bonus and all unused annual leave days up to the Separation Date.
- (2) Withdrawal from the provident fund plan and LTIP in accordance with the plan rules.

⁴ Press release (XX Month 2019)

⁵ Letter to IRD (12-08-2021) in answer to Question 3; and letter to IRD (06-05-2022) in answer to Question

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- (3) As compensation for loss of office and associated hardship and acceptance of the terms set out in the Termination Letter, a severance payment of \$8,909,157 (**‘Severance Payment’**).

37. As provided in the Termination Letter, in accepting the Severance Payment, the Taxpayer agrees that, except for claims of indemnity that might arise under the Deed,

- (1) He would have no claim against Company A and Company F Group on any ground whatsoever;
- (2) He would release Company A and Company F Group from any claims in connection with his employment, the termination of his employment and any other matter whatsoever; and
- (3) He would not bring any claims whether known or unknown and whether or not existed as at the Termination Date against Company A and Company F Group in any jurisdiction whatsoever.

38. The confidentiality agreement under the Employment Contract would continue to apply.

39. The Deed also provides that if in future Company A or Company F Group offered employment to the Taxpayer which was comparable to or more favorable than his present employment with Company A and he accepted such offer, the Taxpayer agreed that he would on demand return to Company A a pro-rated portion of the Severance Payment.

40. The Termination Letter does not refer to the LTIP nor the Taxpayer’s PSUs/RSUs entitlement thereunder.

C7. *Severance Payment and Awards under LTIP*

41. Following termination, the Taxpayer received the Severance Payment and awards realised from the accelerated and full vesting of his RSUs and PSUs under the LTIP.

42. Pursuant to the above, Company A furnished a notification by an employer of an employee who is about to depart from Hong Kong (**‘IR56G’**) for the year of assessment 2019/20 in respect of the Taxpayer reporting, among other things, payment to the Taxpayer of Sum A (\$8,819,157), the calculations of which were explained later as follows:

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	\$
Annual base salary x Title multiplier (\$5,080,560 x 1.5)	7,620,840
Average bonus x Title multiplier (\$858,878 x 1.5)	<u>1,288,317</u>
(the Severance Payment)	8,909,157
<u>Less:</u> Severance payment statutory amount under the Employment Ordinance ((\$22,500 x 2/3 x 6 years)	<u>90,000</u>
(Sum A)	<u>8,819,157</u>

43. Under the LTIP and pursuant to the RSU Notice and the PSU Notice set out above, the Appellant received Sum B (Value of the RSU Award) in the sum of \$1,978,112, and Sum C (Value of the PSU Award) in the sum of \$2,746,943.

44. Company A further furnished the following two additional IR56G in respect of the Taxpayer reporting, among other things, the following particulars for the year of assessment 2019/20:

	1 st Additional <u>IR56G</u> \$	2 nd Additional <u>IR56G</u> \$
Income		
Certain payments from mandatory provident fund scheme	: 934,114	-
Sum B/ Value of the RSU Award	: 1,978,112	-
Sum C/ Value of the PSU Award	: -	<u>2,746,943</u>
Total	: <u>2,912,226</u>	<u>2,746,943</u>

45. In the same letters to IRD dated 12 August 2021 and 6 May 2022 (footnote 7 above) Company A explained the calculations of Sum B and Sum C in reply to the Assessor's enquiries as follows:

Sum B: There was an accelerated vesting to 30 November 2019 of the 1,662 Company J RSUs plus 10 more Company J DEUs that accrued in the meantime, attributable to the Taxpayer's original RSUs. Thus, on the Termination Date, the Taxpayer received 1,672 Company J shares and realised the gains according to the calculations:

<u>Grant Date</u>	<u>Vesting Date</u>	<u>No. of RSUs</u>	<u>Market Price</u> USD	<u>Value of RSUs</u> USD	<u>Exchange Rate</u>	<u>Value of RSUs</u> \$
28-09-2018	30-11-2019	1,672	151.58	253,441.76	7.8050	1,978,112.94

Sum C: There was no accelerated vesting. According to the PSU Notice, the terms and conditions of the PSU Award was amended on 20 February 2018 such that in the event the Taxpayer's employment was terminated at any time following the

completion of the Acquisition, the PSU Award together with DEUs would fully vest on the Termination Date. The PSU Vesting Date remained on 15 August 2020 of the 2,692 Company J RSUs plus 32 more Company J DEUs that had accrued in the meantime, attributable to the Taxpayer's original PSUs. Thus, on 15 August 2020, he received 2,724 Company J shares. His gain was calculated as follows:

<u>Grant Date</u>	<u>Vesting Date</u>	<u>No. of RSUs</u>	<u>Market Price</u> USD	<u>Value of RSUs</u> USD	<u>Exchange Rate</u>	<u>Value of RSUs</u> \$
29-09-2017	15-08-2020	2,724	130.53	355,563.72	7.7256	2,746,943

C8. ***The Advance Ruling***

46. An application was made to the IRD on 18 July 2019 by the group of employers (including Company A) in respect of severance payments made to their employees in Hong Kong under the redundancy arrangement.

47. The Advance Ruling was made by IRD under cover of a letter dated 16 June 2020 to KPMG Tax Services Limited whereby such severance payments (based on Company F Severance Formula) made to employees being made redundant in Hong Kong would not be assessable to salaries tax for the years of assessment 2019/20 and 2020/21. The Advance Ruling is specifically stated not to include those employed under fixed-term arrangements/contracts. The evidence of Ms D as stated in her witness statement dated 3 February 2023 is that the IRD wished to assess each fixed-term contract individually.

D. **Relevant Legal Principles/ Case Authorities**

48. The following provisions in the Inland Revenue Ordinance ('IRO') govern the issue of this Appeal, ie chargeability of Sum A, Sum B and Sum C to salaries tax:

Section 8(1):

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

(a)any office or employment of profit; and

(b)any pension.'

Section 9(1)(a) defines the term '*income from any office or employment*' to include

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‘(a)any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others...’

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

49. It is pertinent to bear in mind that in an appeal before this Board, the appellant taxpayer has the burden of proof throughout, and the Commissioner does not have the burden of proving anything.

50. The real issues of this appeal are whether in respect of each of Sum A, Sum B and Sum C, which were paid to the Taxpayer upon termination of his employment, they were income *‘from’* the Taxpayer’s employment.

51. This Board has considered the following case authorities referred to by both parties in submissions, and the principles stated therein relevant to this Appeal.

52. The applicable principles in considering whether a payment received by an employee upon termination of his employment is taxable were established in the Court of Final Appeal case Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 (Fuchs), in which Ribeiro PJ stated the following:

‘17... Income chargeable under [section 8(1) of the Ordinance] is likewise 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”...’

‘20...in many cases, there will be little doubt that a payment is assessable as “income from employment”. This is so where, for instance, the sum is plainly an entitlement under the contract of employment, such as a lump sum stipulated to be payable in the event of early termination ... or an amount paid pursuant to a clause enabling the employer to terminate by making a payment in lieu of notice ...’

‘22. ... 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... 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”? ... 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.’

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53. In determining whether a sum is an income from employment, one has to ascertain the true nature of the sum and the circumstances giving rise to it. A sum made to an employee upon termination of employment does not necessarily follow that it is not chargeable to Salaries Tax. The sum is taxable if it is paid to an employee (a) in return for acting as or being an employee; (b) as a reward for past services; or (c) as an inducement to enter into employment. The sum is not taxable only if it is not paid under any of those 3 conditions (*‘for something else’*).

54. In Fuchs the payments made to the employee, though described as *‘compensation for loss [of the employee’s] position due to the termination of the employment relationship’*, were held to be taxable. It was found that the accrued right of the employee to be paid upon termination on the facts of that case was sourced in his contract of employment, and so was chargeable to salaries tax. In so holding, Ribeiro PJ cited at paragraph 17, the following passage from Henley v Murray (1950) 31 TC 351, 365 with approval:

‘...language which the parties may use, such as “compensation for loss of office” is not the determining factor when you have to decide what in truth was the bargain, and that the duty of the Court is to see what in substance and in truth the bargain was and not to be blinded by some formula which the parties may have used.’

55. The principles are not disputed, and were affirmed in CIR v Poon Cho Ming John (2019) 22 HKCFAR 344 (Poon), paragraph 14 *per* Bokhary PJ.

56. A helpful and similar summary was provided by Coleman J in Heath Brian Zarin v CIR [2021] HKCFI 1846 (Zarin) at paragraph 26. It is stated at paragraph 26(4) that *‘Income chargeable under s.8(1) is not confined to income earned in the course of employment, but embraces payments made ‘in return for acting as or being an employee’, or ‘as a reward for past services or as an inducement to enter into employment and provide future services’, and at paragraph 26(5) that ‘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.’*

57. The summary of principles by Coleman J at paragraph 26 were approved on appeal by Kwan VP in [2022] HKCA 412 at paragraph 23.

58. In Poon, it was found that the payment in lieu of bonus and share option gain under the separation agreement were to ensure that the employee would *‘go away quietly’* without pursuing legal action against the employer or seeking shareholder intervention. In Zarin, the remuneration paid for assistance in litigation and restricted shares released pursuant to the termination agreement represented new obligations over and above the employee’s obligations under his employment letter. In both cases, applying the test and principles stated in Fuchs, the courts held that the amounts in dispute were not made (a) in return for acting as or being an employee; (b) as a reward for past services; or (c) as an

inducement to enter into employment, but *'for something else'* and hence not taxable.

59. In the case of Commissioner of Inland Revenue v Yung Tse Kwong [2004] 3 HKLRD 192 (*'Yung'*), the taxpayer was paid a sum partly as an inducement to enter into employment and partly for accepting a restrictive covenant not to solicit customers of his ex-employer and not to compete for 12 months from termination. Tang J. (as he then was) concluded that a contractual lump sum paid upon termination of employment might be apportioned into taxable and non-taxable parts. The portion paid to the taxpayer as inducement to enter into employment was taxable. Only that portion paid to the taxpayer as consideration for the restrictive covenant was held non-taxable, ie payment made to the taxpayer for giving up his rights by virtue of the restrictive covenant, and wholly unconnected with his employment.

60. In doing the apportionment in Yung, the Court admitted that it would be hard to decide the value of the offer worth as an inducement at the time of entering into the employment contract. It would depend on factors including the nature of the employer's business, the taxpayer's position in that business and the length of his service. It was found that the acceptability of the restrictive covenants would have been the dominant consideration, and that only 10% was accepted to be inducement to enter into employment, and taxable.

61. A payment can be *'from the employment'* even though there may be other reasons for it. The Commissioner has quoted the explanation of Patten LJ in Kuehne + Nagel Drinks Logistics Ltd v Revenue and Customs Commissioners [2012] STC 840, paragraph 56 as follows:

'... In all the cases I have referred to there are competing causes...In each case the payments were in part motivated by feeling of generosity towards the recipient. Employment does not have to be the sole cause but it does have to be sufficiently substantial as to characterise the payment as one from employment.'

62. Whilst the decided cases provide guidance on the application of the legal principles, it remains the case that it is the statutory words which are to be applied. In determining whether a payment is *'from employment'*, each case ultimately involves applying the statutory language to the facts, and must be considered on its own particular facts.

63. Bearing this in mind, we turn to the particular facts of this case/ evidence adduced by the Taxpayer relevant to this appeal.

E. The Taxpayer's Evidence/Arguments

64. Upon enquiries by the Assessor, the Taxpayer and Company A provided information in documents now placed in the [A] and [R1] Bundles.

65. The Taxpayer supplemented his evidence by oral testimony at the hearing

before the Board.

66. In arguing that Sum A was a compensation for loss of office but not a payment ‘from the employment’, the Taxpayer’s starting point is that there are no terms or conditions in the Employment Contract that give him any right to claim or expect any compensation after the expiry of the contract on 30 November 2019.

67. Regarding Sum B and Sum C paid in respect of the RSUs and PSUs, he points out that the eligibility, grant and terms and conditions of any RSUs or PSUs that he might receive during the term of his employment were always at the discretion of the ultimate parent company Company F. He had no contractual right to claim any RSUs, PSUs or the early acceleration or full vesting thereof in the event his employment was terminated, or if his contract expired without extension or renewal by Company A.

E1. *Sum A*

68. The Taxpayer’s evidence given at the hearing is that he had performed well during his employment as reflected by his promotion from Position G to Position H between his first and second contracts, and his consistently getting the full amount of discretionary bonuses. He also got a retention bonus upon termination to keep working as set out in the breakdown of final payment in the Termination Letter even though Company A was not obliged to pay.

69. On that basis, he should be considered a ‘very good employee’ and had a fair expectation that his employment contract would be renewed and continued long-term. His employment, like many high position executives, would be reviewed every 3 years, and typically renewed as a long-term permanent employment if not for the major Acquisition resulting in redundancy.

70. By fall of 2018, it went public that the Acquisition, described to be ‘a partial takeover’ of Company F by Company J, would likely close in the first half of 2019. It was reported in a news article in Newspaper P dated XX Month 2018 that Company F had sent out a memo the day before to its employees in the US, in the event that their positions were made redundant upon the Acquisition, promising ‘*generous severance*’ to soon-to-be laid-off workers. It was estimated that 5,000 to 10,000 of the 22,000 Company F employees would lose their jobs.

71. The Taxpayer read/heard about this but was uncertain as to his own prospects or position, not even whether the ‘generous severance’ referred to in the memo to the US employees would apply to those outside the US, such as himself who was based in Hong Kong.

72. He first received notification regarding severance a few months later in the XX Month Email from Company A’s human resources: that for all employees who were based outside the US, they would receive severance packages at least as favorable as what their US counterparts were eligible for. It was also the first time the Taxpayer received information (in the Severance FAQ) on the 3-Tier Methodology and the calculations of

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severance package. This was only 5 days before the closing on XX Month 2019.

73. It was in the news on XX Month 2019 that immediately after closing, Company J had started laying off Company F executives.

74. The XX Month Email also states that Company F *‘have worked closely with Company J to specify the severance terms outlined in the merger agreement and related documents...’*

75. The evidence therefore shows that the terms of severance were negotiated at the level of the transactional deal and as part of the Acquisition, for at least a year since the merger agreement was signed in December 2017. The Taxpayer argues that the updates were focused only on the overall process and timeline of the Acquisition, to provide information in the line of so much uncertainty, questions and worries in the vast number of Company F employees. He had remained uncertain as to his own position/prospects of continuing employment despite the updates.

76. There was no discussion or negotiation on quantum of any sort between Company A and the affected employees. It was not necessary for the terminated employees to negotiate quantum, because the Severance Plan was of global application to all soon-to-be-laid-off employees, designed and based on formulae to provide sufficient financial protection and to make them go away quickly and quietly.

77. The Taxpayer’s evidence is that he did negotiate with Company A the waiver and release which he later signed in the Termination Letter; it was not the same standard waiver and release signed by almost all the other terminated employees. It contained a carve-out for an indemnity that was negotiated for and provided by Company A to the Taxpayer, following which a Deed of Indemnity was made by the Employer and the Taxpayer on 30 November 2019.

78. The Severance Plan was announced very close to the closing date, almost at the same time when massive layoffs commenced. It was a global severance plan aiming to provide generous monetary protection of pre-arranged/fixed amounts, fairness and transparency to allow employees affected by the massive layoffs throughout the world to go away quickly and quietly.

79. As stated in the Termination Letter and later explained in Company A’s letter to IRD dated 12 August 2021, following from the Acquisition, as part of the integration of the Department N function for the Asia-Pacific Region and the closure of the Employer’s Hong Kong office, it was decided that the Taxpayer’s position was redundant. He was thus entitled to severance payment, calculated using the Title based methodology given his position as Position H.

80. The Termination Letter specifically refers to Sum A payment as ‘compensation for loss of office’.

81. The Severance Payment followed a standard formula outlined in the global

severance plan. It was based solely on title, with no reference or relevance to past performance or length of past service. As stated in the XX Month Email, the Severance Plan was to ensure that *there is financial protection in the event of* [termination/layoff following the Acquisition].

82. This echoes the waiver and release against Company A and its associated companies that the Taxpayer was required to agree to and sign in the Termination Letter, and ‘*Claims*’, is widely defined to mean ‘*all and any claims or rights of action that you have now or may have in the future relating to your employment, the termination of your employment and any other matters whatsoever (whether under equity, tort, common law, contract, including your employment contract, any bonus, equity plan or performance plan maintained by Company A or any associated Company, or statute as presently existing or as may be amended from time to time) in Hong Kong and any other jurisdiction in the world ...*’

83. Sum A was not a sum paid to reward the Taxpayer for past services during employment, nor was it intended for motivation or inducement to provide future services, as CIR seeks to argue (‘**Motivation Purpose**’).

84. For reward of past services, the Taxpayer did receive, and pay taxes for, separate payments for both performance bonus (identified as pro-rata bonus from 20 March 2019 to 30 November 2019) and a retention bonus as outlined in the Termination Letter; but the nature of Sum A was totally different. It was a payment/compensation/assurance for financial security for loss of office, and for the Taxpayer to go away quietly.

85. The Taxpayer explained in his evidence that he had no choice in the circumstances but to accept the severance as fixed and arranged in the global Severance Plan. He had foregone potential claims - whether known or unknown, whether under the Employment Contract such as for wrongful dismissal, equity, tort, any equity plan or whether due to breach of privacy, racial discrimination, harassment or anything else, of which he had legal knowledge. He had experience in his position as Position H included working with external lawyers in the area of employment law for advice in relation to terminating employment of senior executives and investigating workplace complaints involving discrimination, harassment and other problematic behaviour. Indeed he had sought legal advice regarding his possible potential claims against the Employer before signing the Termination Letter and the Deed.

86. As set out in his Closing submissions, the Taxpayer argues that the rationale for the Severance Plan was to ‘*minimize the prospect of costly and time consuming litigation (or threats of litigation) from multiple laid off employees who were unhappy...in effect, pre-[arranged] amounts to make such laid-off employees go away quietly and quickly en masse*’ – in other words, to avoid the nuisance of employees suing Company F following termination and causing trouble – this is referred to as the ‘**Nuisance Purpose**’ in the Commissioner’s submissions.

87. The generous severance payment was designed to provide sufficient financial protection upon the loss of office. One could easily imagine how difficult it would

be for a high level executive to find a new employment in the event of layoffs upon the merger of two world famous major competitors, as the Taxpayer in the present case. In the Taxpayer's case, he had returned to Country K after the termination and could not since have a career nor a practice in law.

88. Regarding apportionment of taxable/non-taxable portions of Sum A, the Taxpayer criticizes the Deputy Commissioner's Determination in that it has not offered any logical or legal rationale for why only part of Sum A is not assessable to salaries tax. The sum was calculated based on a general formula under the Severance Plan designed for calculating redundancy pay in a mass lay-off situation. The whole Severance Payment was not 'from the employment'; any allocation would be nonsensical and in direct contradiction of the legal test laid down in Fuchs.

E2. *Communications with the IRD Officers*

89. The Taxpayer gave evidence that during his telephone conversations with two IRD officers, namely Yun (Assessor) and C Chan (Senior Assessor), during April to June 2022, he was verbally advised or confirmed that Sum A was a payment for loss of office based on the wording of the Termination Letter, and should be excluded as being non-taxable.

90. Yun and C Chan was called at the hearing to deal with such evidence and for cross-examination. Without going into details of their evidence, this Board found them truthful witnesses and accept their evidence (which is in fact largely consistent with the Taxpayer's evidence). We make the following factual findings:

- (1) Yun did express to the Taxpayer her view that upon reviewing the documents, Sum A was a payment for loss of office and could be excluded, ie not assessable to income tax, but it would be subject to the approval of her senior;
- (2) C Chan did discuss the case with Yun and knew about the latter's view expressed to the Taxpayer regarding exclusion of Sum A; and
- (3) In his subsequent telephone conversations with C Chan, the Taxpayer referred to Yun's conclusion regarding exclusion of Sum A. Without confirming her own view on the issue nor disagreeing with Yun's conclusion, C Chan informed the Taxpayer that it would be subject to the final decision in writing of the IRD.

E3. *The Advance Ruling*

91. The Taxpayer also relies on the Advance Ruling to Company A provided by IRD that acknowledged payments made to employees being made redundant, and receiving payments under the Severance Plan would not be assessable to salaries tax. It has however specifically excluded executives (such as the Taxpayer) who were employed under fixed-term contracts, as the IRD wished to assess such cases individually, or to determine whether

any portion of termination payments could be related to provisions under the fixed-term contracts.

92. In the Taxpayer's case, IRD could not refer to any of Sum A being payable under his fixed-term contract, or for any past services or inducement for future services. He argues that the Advance Ruling should apply to Sum A as the Severance Plan is a global arrangement and should be applied consistently to calculate only redundancy payments to employees whether or not they were under fixed term or indefinite employment contracts.

E4. *Sum B and Sum C*

93. The Taxpayer argues that although Clause 4 of the Employment Contract provides for the Taxpayer's entitlement under LTIP, the eligibility, grant and terms and conditions of any awards of RSUs or PSUs were always at the discretion and subject to the prevailing policy of the ultimate parent company Company F, and the Taxpayer had no contractual right to claim these awards or the early acceleration thereof in the event of termination or non-renewal of his employment.

94. Sum B and Sum C received from the accelerated or full vesting of the remainder of the unvested and outstanding RSUs and PSUs, respectively, upon termination of his employment was triggered solely due to his loss of office following the Acquisition. The payments were not made under any provisions of any of his employment contracts.

95. Such payments were not '*from employment*', as he could not sue for accelerated or full vesting of any remaining unvested and outstanding RSUs and PSUs under his employment contract. Indeed the release and waiver the Employer required him to sign had removed any ability of him to make a legal claim on the remainder of the unvested and outstanding RSUs and PSUs.

96. He further argues that the specific amendments provided for the accelerated or full vesting of RSUs and PSUs in the event of termination of employment for 'good reason' (other than for termination for cause or due to death or disability) at any time following the completion of the Acquisition, resulting in payments of Sum B and Sum C, were effectively part of the overall severance plan. The amendments to the LTIP in the last set of the RSU Notice and the PSU Notice were to encourage terminated senior executives to go away quietly. If not for such amendments, these senior executives being made redundant would no longer be able to receive their shares under the LTIP as they would no longer be employees of Company F on the vesting dates.

F. *Analysis*

97. In considering the substance and true nature of Sum A, Sum B and Sum C for the purposes of the IRO, this Board has considered all relevant evidence, the legal principles and the parties' submissions. We consider the evidence of the Taxpayer on the background and events leading to his termination of employment, largely unchallenged, important.

F1. *Whether Sum A should be assessable to salaries tax*

98. We accept the Taxpayer's evidence and arguments outlined in paragraphs 68 to 87 above that Sum A was not a payment 'from the employment' but was for loss of office.

99. The entitlement to Sum A payment is not provided anywhere in the Employment Contract, based on which the Taxpayer would not have any right to sue or enforce payment, similar to the situations in Poon and Zarin in which the payments were found not 'from the employment' and not taxable.

100. Sum A was a payment made pursuant to the generous global Severance Plan in the mass layoffs situation, aiming at providing sufficient or appropriate financial protection to those employees being laid off and making them go away quickly and quietly, ie for the Nuisance Purpose.

101. This is supported by the evidence of the waiver and release that the Taxpayer was required to agree and sign in the Termination Letter and his evidence of negotiation with Company A on the waiver and release. His right to payment of Sum A was contingent on him providing the waiver and release, giving up his legal rights to all or any potential claims, past present or future, known or not known.

102. Indeed the Deputy Commissioner in the Determination has acknowledged and accepted the Nuisance Purpose in excluding a part of Sum A from the assessable income.

103. The payment was not a reward for past services, nor as an inducement or motivation for future services. Even though the restrictive covenants provided in the Employment Contract stipulated that Company A might extend the employment for a further period not exceeding 6 months, this in our view would not amount to an inducement for future services.

104. The timing when the Severance Plan was first made known or announced, only a few months prior to termination of the Taxpayer's employment, does not support the Commissioner's suggestion that Sum A was incentive and motivation for him to continue to work hard and perform well until termination, ie the Motivation Purpose.

105. The nature and purposes of Sum A are different from those of the performance bonus paid for past good services, and the retention bonus paid for motivation purposes, for which the Taxpayer had paid tax.

106. The fact that the Severance Plan was announced to the Hong Kong employees only a few days prior to the closing date, at the same time when massive layoffs commenced, supports the Taxpayer's arguments that the Severance Plan was to pay generous pre-arranged amounts to the laid-off employees to make them go away quickly and quietly. This is similar in nature to the payments in lieu of bonus and share option gains under the separation agreement in Poon, in which payments were found to be paid to ensure

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that Mr Poon would ‘go away quietly’ without pursuing legal action against the employer or seeking shareholder intervention.

107. The Commissioner relied on the wording in Company F’s October 2018 memo to the US employees to argue on the Motivation Purpose of the Severance Plan: ‘...(Company F) *needs to be a completely functional and successful business on the day this deal closes and the new company will need to be fully staffed...*’

108. This we interpret to mean no more than ensuring sufficient staffing and continuous operation, conducive to a smooth transition before and after the Acquisition and restructuring, but not as an incentive or motivation to the soon-to-be laid off employees to work hard in the remaining few months of their ending employments.

109. The fact that the Severance Plan not being made available to those who would be kept or offered an equivalent role by Company F, presumably the best employees (as argued by the Taxpayer), and for those who would be hired back later would have to return a portion of the severance payments, also does not sit well with the Motivation Purpose argument, which we found illogical and not sustainable.

110. We do not accept the Commissioner’s arguments that the part of severance payments paid in excess of the contractual outstanding wages should be considered as a gratuity for the employees’ past services and/or in return for them having acted as employees. There is no evidence in support of this argument. The evidence points to a generous severance package aiming to provide sufficient and appropriate financial protection in the event of layoffs.

111. We accept the Taxpayer’s evidence on the negotiation and his seeking legal advice, leading to the agreement and signing of the release and waiver, as being supportive of the Nuisance Purpose. The global severance policy being made generous to provide severance payments in excess of the contractual outstanding wages is also consistent with this purpose.

112. There is no requirement of negotiation on quantum of the termination payments in order to render them non-taxable, or evidence of threats of legal actions or actual legal actions having been taken. The legal test as shown in the leading authorities Fuchs, Poon and Zarin remains the substance and real purpose of the payments.

113. We conclude that Sum A, as stated in the Termination Letter, was a severance payment made upon redundancy resulted from the Acquisition, and as *compensation for loss of office, the associated hardship and acceptance of the terms stated* therein. That we accept to be the specific purpose of Sum A paid to the Taxpayer upon termination.

114. It is not shown that any particular portion of Sum A was ‘from the employment’ or for other purposes such as past services, or for inducement or motivation for future services, unlike the case in Yung cited above. There is no justification for apportionment.

115. There is in our view no justification either nor explanation for the basis of exclusion from the assessable income of an amount equivalent to the Taxpayer's annual base salary out of Sum A as concluded in paragraph 1(16) of the Determination.

116. This Board found that the whole of Sum A should not be taxable.

F2. *Communication with the IRD Officers*

117. Having come to the conclusion that Sum A was in nature and substance a payment for loss of office and should not be chargeable to salaries tax as explained above, it is not necessary for this Board to rule on the effect of the telephone communications with the IRD officers Yun and C Chan.

118. For completeness sake, this Board accepts the Commissioner's argument that such communications are irrelevant for the purposes of the IRO. They at most represent the personal and qualified views of Yun. The evidence of Yun and C Chan is that whatever their personal views might be on the taxability of Sum A, the matter would be subject to the final and official decision in writing of the superior/ IRD.

119. These communications have no bearing on this Board's consideration and conclusion of taxability of Sum A. The legal test remains what was in substance and in truth the nature of Sum A with reference to all the circumstances resulting in its payment.

F3. *The Advance Ruling*

120. There is in our view some force in the Taxpayer's arguments that there is no reason why the Advance Ruling should not apply to Sum A when the same global Severance Plan is applied consistently to calculate redundancy payments to employees whether or not they were under fixed term or indefinite employment contracts.

121. The Deputy Commissioner in his Determination seems to have given effect to the Advance Ruling by excluding the Taxpayer's annual base salary (ie the maximum non-taxable amount in the case of Position H) out of Sum A from the assessable income.

122. Without reference to the Advance Ruling, this Board has upon considering all the evidence and the circumstances under which payment of Sum A was made to the Taxpayer, focusing on its nature and substance, found that the whole of Sum A should not be assessable to Salaries Tax,

F4. *Whether Sum B and Sum C should be assessable to salaries tax*

123. Sum B and Sum C are of a different nature.

124. Unlike Sum A the payment of which was not provided anywhere in the Employment Contract, the Taxpayer's entitlement under the LTIP is provided under clause 4 of the Employment Contract. He was pursuant to this scheme granted the PSU Award and

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the RSU Award during the term of his employment respectively on 29 September 2017 and 28 September 2018. The LTIP forms part of the Employment Contract.

125. Both RSUs and PSUs were equity award schemes – the essential difference is that RSUs would vest over a specified schedule, whilst PSUs would vest upon the attainment of specified performance goals.

126. The amendment of the terms of any outstanding award or waiver of any conditions or restrictions applicable to any award under the LTIP was authorized under the LTIP.

127. Notably, the LTIP expressly provided that the terms and conditions of both the LTIP and the awards could, subject to various conditions, be amended from time to time, save that they could not be amended to *impair* the employee’s entitlements without their consent.

128. There is no question that the LTIP, the PSU Notice and the RSU Notice are legally binding documents. They formed a part of, or were originated from, the Employment Contract, based on which the Taxpayer would be entitled to enforce payment of Sum B and Sum C against Company A. The PSU Award and RSU Award accrued and were granted, and the PSU Notice and the RSU Notice had become effective, in the course of the Taxpayer’s employment in 2018. They should all be regarded as part of his employment package.

129. Sum B and Sum C automatically vested pursuant to the terms of the PSU Notice and the RSU Notice, to which Company A did not have any discretion.

130. Notwithstanding that the PSU Notice and the RSU Notice were amended and issued to take into account the effects of the Acquisition, to enable the accelerated and full vesting of the RSUs and PSUs, and eventual payments of Sum B and Sum C upon termination of the Taxpayer’s employment pursuant to redundancy resulted from the Acquisition, there is no question that the PSU Award and the RSU Award were both provided and granted under the Employment Contract and the LTIP, and were ‘from the employment’.

131. Applying the legal principles and test stated in Fuchs, we conclude that Sum B and Sum C were in substance ‘*income earned in the course of employment*’, and ‘*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*’ quoted in the judgment of Ribeiro PJ.

132. As to the purpose of Sum B and Sum C, as the title of the plan ‘*Long-Term Incentive Plan*’ denotes, it was intended to *make awards to certain employees as an additional incentive for them to make contributions to the financial success of Company A*. The awards were performance-based, and the purpose was motivation/ inducement for future services to drive and reward the employees working hard and contributing to the long-term growth of the parent company. The purpose of the three-year vesting provision

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was to encourage executives to stay with companies longer. The awards were vested during employment and to reward past services.

133. We are therefore inclined that the nature and purpose of the awards of PSUs and RSUs under the LTIP based on which Sum B and Sum C were eventually paid was for the Motivation Purpose, ie in return for the Taxpayer acting as or being an employee, as an inducement to motivate hard work in the promotion and attainment of performance targets of Company A.

134. The relevant terms of the RSU Notice and the PSU Notice were put in effect during the Taxpayer's employment, in anticipation of the Acquisition. We consider that their purpose was to pay out the awards under the LTIP as a reward for past services and/or as a financial incentive to maintain the quality of his work notwithstanding the uncertainty of tenure.

135. We have considered the authorities of Poon and Zarin relied upon by the Taxpayer in arguing the non-taxability of Sum B and Sum C. The circumstances surrounding the payouts in those cases were different. The taxpayers had at the time of termination no legal right to the accelerated vesting, which was then entirely in the discretion of the employer who decided to vest them only as part of the termination. Hence payments of those share awards were found to have arisen because of termination, and not related to past services or employment, and were not taxable.

136. In Poon (paragraph 63), Bokhary NPJ said there *'is no – nor could there possibly be any – suggestion that the acceleration of vesting leading to the Share Option Gain was given to induce the Taxpayer to provide future services.'* That conclusion was premised on the fact that the gain was found awarded to Mr Poon as part of the termination package, and he had no services left to render.

137. In Zarin, it was found that the share award was part of the termination package, not 'from the employment' and not taxable, as stated by Kwan VP (at paragraph 54) that *'the Taxpayer was not contractually entitled to the vesting of the 2012 Shares even though a grant was made, as, under the Plan, the remuneration committee had absolute discretion at any time to reduce or cancel an award or impose additional conditions before the vesting of the awards; and where a "good leaver" had entered into a termination agreement, the award would not vest until he had complied with or was released from his obligations under the termination agreement.'*

138. In the present case, Sum B and Sum C were paid to the Taxpayer pursuant to the RSU Notice and the PSU Notice which as we have concluded formed part of the employment package. Payment of Sum B and Sum C was automatic upon the terms of the RSU Notice and the PSU Notice, to which Company A did not have any discretion. They were not part of the termination package, nor originated from the termination at Company A's discretion.

139. This is consistent with evidence that Payment of Sum B and Sum C was not mentioned in the Termination Letter.

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140. For the above reasons, we accept the Commissioner's arguments that Sum B and Sum C were in substance and in truth the Taxpayer's entitlements and payments 'from the employment' and for incentive purpose under the LTIP, hence should be chargeable to salaries tax.

G. Conclusion

141. The Appeal is allowed to the extent that this Board found the whole of Sum A in the sum of \$8,819,157, ie the Severance Payment less the statutory severance payment of \$90,000, should not be chargeable to salaries tax.

142. With regard to Sum B and Sum C, this Board confirms the Deputy Commissioner's decision in his Determination dated 8 November 2022 that the whole of Sum B and Sum C in the respective sums of \$1,978,112 and \$2,746,943 should be chargeable to salaries tax.

143. We consider it appropriate to make no order as to costs.