Case No. D9/24

Salaries tax – whether termination payment was chargeable to salaries tax – whether the termination payment was accrued during the employment in Hong Kong - whether payment under incentive plan was taxable – whether new issues could be raised – section 8(1), section 66(3) and section 68(7) of the Inland Revenue Ordinance

Panel: Clark Douglas Stephen (chairman), Fok Bryan and Law Man Chung SC.

Date of hearing: 23 April 2024.
Date of decision: 23 September 2024.

The Appellant was first employed by Company A as Position B under the Company A Contract in September 2015. Shortly after the Company A Contract was executed, by way of the Company H Contract, the Appellant was assigned by Company A to Company H in Hong Kong as Position J. The Company H Contract provided that, except for the stipulations regarding the right to terminate the contract, the mutual rights and obligations under the Company A Contract would be suspended. The Company H Contract was effective for a period of two years, up to October 2017. Under both Company A and Company H Contracts, the Appellant was paid a basic salary and discretionary bonus.

In April 2016, Company issued a letter informing the Appellant that he was entitled to participate in Company A's long term incentive program ('LTI'), which was separate from the bonus incentive under the Company A and Company H Contracts.

The Company H Contract was extended for an extra month and terminated in November 2017. The Appellant left Hong Kong immediately, whilst the Company A Contract remained extant.

The Company A Contract was terminated by agreement with effect from 31 December 2018. The termination agreement stipulated that the Appellant was entitled to the payment under the LTI. Accordingly, Company H made a payout of EUR 112,444.43 (equivalent to HK$976,902) to the Appellant. For the 2017/18 year of assessment, the payout under the LTI was assessed for salaries tax. The Appellant objected to the assessment but the Commissioner confirmed the assessment by way of a Determination dated 1 November 2023. The Appellant appealed.

The principal grounds of appeal were that the payout of HK$976,902 was an agreed termination payment under Company A Contract and that the negotiation of the termination agreement took place outside Hong Kong and the payment was made well after the Appellant had left Hong Kong, and hence it had no connex to Hong Kong.

The subject matter of this appeal concerns whether the termination payment is

taxable under section 8 of the Inland Revenue Ordinance ('IRO').

After the appeal being heard by the Board on 23 April 2024, the Appellant attempted to submit new evidence and raise two new grounds of Appeal.

Held:

(1) The Board applied the principles set out in Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 and Commissioner of Inland Revenue v Poon Cho Ming, John (2019) 22 HKCFAR 344. Income chargeable under section 8(1) of the IRO was not confined to income earned in the course of employment but embraces payments made (i) in return for acting as or being an employee, (ii) as a reward for past services or (iii) as an inducement to enter into employment and provide future services. Furthermore, if a payment, viewed as a matter of substance and not merely of form, was found to be derived from the Appellant's employment, it is assessable.

(2) The Board found that the termination payment of HK$976,902 was calculated by reference to the LTI. Moreover, after considering the wording of the termination agreement, the Board ruled that the termination payment had accrued during the Appellant's employment in Hong Kong. Hence, the Board determined that the termination payment was taxable under section 8(1) of the IRO.

(3) Pursuant to section 66(3) of IRO, the Board declined to grant the Appellant leave to raise new issues because no strong new grounds or good reasons had been advanced for the delay. Nevertheless, the new issues raised by the Appellant would not affect the outcome of this appeal.

Appeal dismissed.

Cases referred to:

Commissioner of Inland Revenue v Crown Brilliance Ltd [2016] 3 HKC 140
Commissioner of Inland Revenue v Elliot, Stewart William George [2007] 1 HKLRD 297
Commissioner of Inland Revenue v Poon Cho Ming, John (2019) 22 HKCFAR 344
Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74

Appellant in person.
Cheng Nga Man, Yau Yuen Chun and Lee Shun Shan, for the Commissioner of Inland Revenue.

Decision:

Introduction

1. The Appellant objects to a Determination by the Deputy Commissioner of Inland Revenue ('the Commissioner') dated 1 November 2023 that a sum of EUR 112,444.43 (equivalent to HK$976,902) is chargeable to Salaries Tax in the year of assessment 2017/2018 ('the Determination').

2. This is an appeal lodged by the Appellant on 28 November 2023 against the Determination pursuant to the provisions of section 66 of the Inland Revenue Ordinance (Chapter 112 of the Laws of Hong Kong) ('the Ordinance').

3. The hearing of the appeal was on 23 April 2024. The Appellant appeared in person and the Commissioner appeared by Miss CHENG Nga-man, Assessor (Appeals), IRD.

4. The Appellant did not lodge witness statements nor any written submissions before the hearing. The Appellant did write to the Clerk to the Board by email on 12 December 2023 stating that he did not anticipate calling witnesses and that his submission (meaning his Notice of Appeal) contains all relevant information.

5. The appeal was heard on 23 April 2024. After the hearing, the Appellant sent a letter dated 8 May 2023 requesting that his statements be considered as under oath or that a second hearing be convened for him to give evidence under oath and be cross-examined. The Appellant also sought to submit new evidence in the form of certain emails regarding the termination of his contract. The letter attached Closing Submissions that had not been requested by the Board. The Closing Submissions for the most part reiterated what had been said at the hearing but did raise two new grounds of appeal.

6. The Appellant has previously written to the Commissioner seeking the Commissioner's agreement to file new evidence. The Commissioner by a letter dated 2 May 2024 did not agree. The Commissioner also wrote to the Clerk to the Board on 17 May 2024 objecting to the admission of new evidence. The letter said that the Commissioner had not seen the new evidence.

7. The Board has considered this and determined:

   (a) The Board did not consider it necessary to reconvene for the Appellant to give evidence under oath.

   (b) The Board will not accept new evidence or new grounds of appeal. The Board will consider the Closing Submissions as far as they relate to matters covered in the Notice of Appeal. The Board considered the following grounds to be new issues which could not be raised:

(i) Paragraph 8 of the Closing Submissions; and

(ii) Those matters in paragraph 7 of the cover letter, which are also referred to in the penultimate sentence of paragraph 6 of the Closing Submissions.

8. The Parties were notified of this decision by a letter from the Clerk to the Board dated 18 July 2024. The Board gave the Commissioner 7 days to file succinct reply submissions, if he wished to do so. The Commissioner replied on 19 July 2024 that he had not seen the Appellant's documents. The documents were sent to the Commissioner on 19 July 2024 and the Commissioner was given until 30 July 2024 to respond. The Commissioner filed short reply submissions on 29 July 2024.

9. The Board's reasons for not allowing the Appellant's application are as follows:

10. Section 68(7) of the Ordinance provides:

> *'At the hearing of the appeal the Board may, subject to the provisions of section 66(3), admit or reject any evidence adduced, whether oral or documentary, and the provisions of the Evidence Ordinance (Cap. 8), relating to the admissibility of evidence shall not apply.'*

11. Section 66(3) of the Ordinance provides:

> *'Save with the consent of the Board and on such terms as the Board may determine, an appellant may not at the hearing of his appeal rely on any grounds of appeal other than the grounds contained in his statement of grounds of appeal given in accordance with subsection (1).'*

12. Under Section 68 (7), the Board is not bound by strict rules of evidence. Nevertheless, as explained by G Lam J (as he then was) in CIR v Crown Brilliance Ltd [2016] 3 HKC 140 *'a fact is not proved by its assertion in argument. It is proved by evidence, oral or documentary. The representations and oral submissions made [on behalf of a party], without more, do not amount to evidence.'* However, *'contemporaneous documents submitted [on behalf of a party], at any rate those documents whose authenticity is not in dispute, may be considered by the Board as admissible documentary evidence.'*

13. The Board is satisfied that it has sufficient evidence before it to determine the matter fairly between the parties. As far as the Appellant's submission could be considered to be factual evidence they were for the most part supported by the documentary evidence. The Commissioner had an opportunity to rebut these submissions by reference to the evidence. This decision is based on the documentary evidence that was adduced.

14. The new evidence the Appellant sought to adduce was to establish the Appellant had signed his Termination Agreement later than 20 November 2018 when it was dated. As explained at footnote 1 to paragraph 29 below, the date of signing is not relevant.

Both parties agree that it was signed.

15. Section 66(3) provides that new grounds of appeal may not be raised without leave of the Board. Unless there are very strong new grounds or good reasons for failing to raise them before, procedural fairness requires all issues be raised before a hearing. The new grounds could have and should have been raised earlier. The Board does not consider them to be particularly strong and sees no reason to allow them to be raised. As the new grounds require an understanding of the facts and legal issues raised, the Board explains why it does not consider them to be strong at the end of this decision.

Background facts and relevant evidence

16. The background to this matter and relevant evidence are set out below.

17. By an employment contract dated 22 September 2015 ('the Company A Contract'), the Appellant was employed by Company A as Position B with effect from 1 November 2015. The Appellant was at the time the contract was signed and employed by the Company C in Country E. Company C granted him permission to take unpaid leave from 1 December, 2015 to 29 November, 2017 to take up the position with Company A.

18. The Company A Contract, among other things, had the following terms and conditions:

(a) The Appellant's position should be based in City F, Country G. However, Company A reserved the right to transfer him to a different place of work if needed. That reservation of right was also applicable to his employment with another company with the Company A Group ('the Group'). (Clauses 1a, 1b and 1c)

(b) In case another company within the Group assumed the Appellant's scope of duties, the Appellant agreed that his employment including all rights and duties should be transferred to that company. (Clause 1d)

(c) The Appellant's employment could be terminated by either party with a notice period of three months to take effect at the end of a calendar month. Any notice of termination should be in writing. (Clauses 13a and 13b)

19. By an International Assignment Contract dated 24 September 2015 ('the Company H Contract'), the Appellant was assigned by Company A to Company H (which changed its name to Company K in July 2017) ('Company H') in Hong Kong as Position J effective from 1 November 2015 under, among other things, the following terms and conditions:

(a) For the term of the Company H Contract, the mutual rights and obligations under the Company A Contract would be suspended.

(b) However, subject to compliance with the stipulations outlined under Article 1.2, all stipulations of the Company A Contract regarding the right of the Appellant and Company A to terminate the contract would remain in force. (Article 1.1)

20. The Company H Contract was limited to a period of two years. The Company H Contract could be terminated by either party by giving notice for a notice period which was equal to the notice period stipulated in the Company A Contract.

21. The Company H Contract would terminate at the same as the Company A Contract would terminate. For termination of employment, the stipulations of the Company A Contract applied, in particular but not exclusively regarding the applicable notice period. The right to terminate the Company H Contract as well as the Company A Contract for good cause should remain unaffected. (Article 1.2)

22. Both the Company A Contract and the Company H Contract contained, among other things, the following terms:

(a) The Appellant's annual base salary should be EUR 185,000. (Clause 3a of the Company A Contract and Article 2.1 of the Company H Contract)

(b) Further to the annual fixed salary, the Appellant might earn a variable compensation (bonus) each business year as follows.

23. A letter dated 1 April 2016 was sent to the Appellant (care of Company H) entitled Company A Cash & Carry Long Term Incentive – Grant Letter. This informed the Appellant that he was entitled to participate in the Company A Cash & Carry Long Term Incentive ('CC LTI') program. This provided for a three years performance period. The target amount for the Appellants then current position for the full 36 Months Performance Period for the Appellant was EUR 80,000 gross. The CC LTI program for the Appellant was related to a country portfolio of 70% CC CHINA and 30% CC JAPAN. The applicable terms and conditions were stated to be set out in a Plan Document dated April 2016. The grant letter provides that all attachments were an integral part of the grant letter.

24. The Plan Document dated April 2016, provided in paragraph 3.9 that the CC LTI would not be paid out if the employee's contract with the employing company was terminated. However, there was a proviso that certain other provisions would apply in certain circumstances. Of relevance to this Appeal, paragraph 4.6 was stated to apply. Paragraph 4.6 provided that in the case of fixed term contract, the employee will remain entitled to payment in line with the terms of the plan but that he/she would cease to accrue the target amount at the end of the last month which he was employed. Paragraph 3.9 also provided that 'in deviation from the regulation above, the Participant does not lose his right to receive a payout if … his/her employing company was responsible for terminating the contract before the end of the Performance Period.' 'Responsibility' was defined as meaning 'the Participant was entitled to terminate the contract for cause due to a dereliction

of duty on the part of the employing company – or in the case of a termination agreement, would have been entitled to do so.'

25. The bonus under the Company A and Company H Contracts and the CC LTI program were two separate forms of incentive offered to the Appellant. The Determination could be read that he considered them to be the same incentive program, which is not correct. However, this appeal was argued by both parties solely in relation to the CC LTI and the Commissioner did not rely on those terms of the contract relating to the payment of a bonus.

26. That the Commissioner was relying on the CC LTI program was made clear in the Commissioner's letter dated 29 July 2024 in response to the Appellant's closing submission. The letter also stated that the Commissioner's case was the payment under the CC LTI was paid under the proviso to paragraph 3.9 cited above and it was not the Commissioner's case the LTI Payment had been forfeited on 30 November 2017.

27. The Company A and Company H Contracts also provided that the Appellant should hold any and all company business and operational secrets confidential and should not disclose to any other matters and business activities which he became aware of in the course of his employment. He should ensure that third parties did not receive unauthorized information relating to business and operation secrets. The restriction imposed on the Appellant regarding the confidentiality would continue after termination of his employment. (Clause 11d of the Company A Contract and Article 20.5 of the Company H Contract)

28. The Appellant's two years contract with Company H was extended for an extra month. It was terminated with effect from 30 November 2017. He left Hong Kong immediately and returned to work for Company C from December 2017. His contract with Company A remained extant.

29. By a termination agreement dated 20 November 2018[1] ('the Termination Agreement'), the Appellant's employment with Company A was terminated with effect from 31 December 2018 under, among other things, the following terms and conditions:

(a) The employment relationship between the Appellant and Company A should terminate on 31 December 2018 at Company A's instigation for avoidance of an otherwise inevitable forced redundancy. (Clause 1(1))

(b) On 31 December 2018, any and all other service and employment relationships the Appellant might have with other Company A

[1] In his closing submissions, the Appellant said that he only signed the Termination Agreement on 1 March 2019 and presented some email evidence to support this. The Commissioner objected to the admission of this evidence. The Board notes that in all his submissions to the Commissioner and in this Appeal he had not challenged the date of the Termination Agreement as being 20 November 2018. (See for example his letter date 22 February 2021 to the Commissioner and paragraph 24 of the Notice of Appeal (which states the Agreement was signed on or around 20 November 2018)). The Board does not consider the date of signature to be material. It is accepted by both parties the Termination Agreement was signed.

companies should likewise terminate. (Clause 1(3))

(c) The Appellant should keep secret confidential and should not disclose to a third party any business and operational secrets of Company A and any other companies within the Group even after termination of his employment. (Clause 9)

(d) Upon signing of the Termination Agreement, all mutual claims of the parties from the employment relationship or in connection with its termination as well as any other legal reason were compensated and settled except for claims arising from the Termination Agreement. (Clause 10(1))

(e) A mutual agreement as to good conduct providing that neither party would make depreciatory remarks about each other. (Clause 12)

30. Of most importance to this appeal, the Termination Agreement provided at Clause 2(1):

> 'In deviation from the plan conditions of the CC LTI, the payment entitlement from the plan does not expire upon conclusion of this termination agreement. You remain entitled to payment with the target amount of **EUR 44,444.44** accumulated up to the exemption date (30 November 2017). Payment will be made in accordance with the plan conditions after the plan term of the Company A Long Term Incentive.'

31. By a letter dated 25 April 2019 headed 'CC LTI – Your individual payout' ('the Payout Award Letter'[2]), Company A informed the Appellant, among other things, the following details in respect of his payout under the CC LTI:

(a) The performance period of the CC LTI had ended on 31 March 2019. That specific LTI was developed along its New Operating Model and based on VCP target achievement of the countries in 2016.

(b) The Appellant was entitled to a payout of EUR 112,444.43 (equivalent to HK$976,902) ('the LTI Payout').

(c) Company A thanked the Appellant and his teams for the strong contribution to the success of Company A and the transformation in the preceding three years.

32. A calculation sheet attached to the Payout Award Letter showed, among other things, the Appellant's target achievements and calculation of the Payout as follows:

[2] The Commissioner in the Determination referred to this as a 'Bonus Award Letter'. To avoid any confusion with the Bonuses to be paid under the contract, 'Payout Award Letter' is used. The letter itself in the calculation sheet did refer to a 'Calculated Bonus'.

(i) Target value

Valid from	Valid to	Target value (36 months)	Target value (pro rata)
1 Apr 2016	30 Nov 2017	EUR 80,000.00	EUR 44,444.44

(ii) Calculation of the Payout

Target value (pro rata)	Factor	Calculated bonus[3]
EUR 44,444.44	2.53	EUR 112,444.43

33. The Target Center[4] identified in the letter with a 100% weighting was CC CHINA. (The Appellant noted that this was different to the initial grant letter where the performance of CC CHINA (70%) and CC JAPAN (30%) would be taken into account.)

34. The Appellant was assessed for salaries tax for the year of assessment 2017/18. This was paid. After the LTI Payout was paid Company H furnished an additional notification for the year of assessment 2017/18 in respect of the Appellant reporting, among other things, the following particulars:

(a)	Income: The LTI Payout	 $976,902
(b)	Whether the employee's Salaries Tax liabilities will be borne by employer:	No

35. Based on the additional notification, the Assessor raised on the Appellant the following Additional Salaries Tax Assessment for the year of assessment 2017/18:

	$
The LTI Payout	976,902
Add: Additional rental value ($976,902 x 10%)	97,691
Additional Net Chargeable Income	1,074,593
Additional Tax Payable thereon	172,879

36. The Appellant objected to the Additional Assessment on the principal basis that the ground that the LTI Payout was a termination payment and should not be chargeable to Salaries Tax. He relied on a number of grounds which were also argued before the Board. These will be dealt with in the Board's decision below.

37. The Commissioner confirmed the additional assessment by way of a Determination dated 1 November 2023.

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[3] The words 'Calculated bonus' were used in the letter.

[4] That is, the business area the target of the bonus calculations. These were two countries which are identified in capital letters in this decision.

Grounds of Appeal

38. The Appellant lodged a Notice of Appeal on 28 November 2023 appealing to the Board against the Determination claiming that LTI Payout should not be chargeable to Salaries Tax. This was a detailed document setting out full grounds.

39. The Appellant's grounds were summarised by the Commissioner's representative in her written submissions for the hearing as follows[5]:

(a) The LTI Payout was paid to him for entering into the Termination Agreement which contained the 'Settlement and Waiver' clause (ie Clause 10) and 'Good Conduct' clause (ie Clause 12).. The Appellant further asserted that the breach of an alleged verbal agreement between Company A and him to return to the Group six months after the Cessation Date and his then current employment with Company C which had business relationship with the Group led to the conclusions of these two clauses and payment of the LTI Payout.

(b) The LTI Payout was not income from employment. The LTI Payout was not a payment under the CC LTI plan, it was a 'Termination Payment' agreed by him and Company A which used the CC LTI's mechanism for calculation purpose only.

40. At the hearing the Appellant basically agreed that these formulated his principal grounds of appeal. He added:

(a) The geographic connex was missing from the Commissioner's summary. It was agreed that he left Hong Kong on 29 November 2017. At the time he left he did not have a right to the termination payment or payment under the CC LTI plan.

(b) The subsequent work of negotiating this payment happened outside of Hong Kong. So, there is really no connex to Hong Kong. The element of the time when the agreement was reached well after he left Hong Kong is not present in all the other cases cited. In Elliot[6], Poon[7], Fuchs[8], the termination, the negotiation, the agreement of the termination agreements in all those cases and the payment all happened in or around the same time. Whereas, in the Appellant's case, there is a one and half year gap between the negotiation of the termination agreement and the subsequent payment. The Appellant confirmed that he was referring to the time gap of about 1 year between 30 November 2017 when he left Company H and 20

[5] The Commissioner referred to the LTI Payout as a 'Bonus'. This is changed to LTI Payout for ease of reference.
[6] Commissioner of Inland Revenue v Elliot, Stewart William George [2007] 1 HKLRD 297
[7] Commissioner of Inland Revenue v Poon Cho Ming, John (2019) 22 HKCFAR 344
[8] Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74

November 2018, the date of the Termination Agreement.

41. The Appellant filed Closing Submissions. While not requested by the Board, given the Appellant was unrepresented, as set out above, it will consider the Closing Submissions as far as they relate to the substance of the case and relate to grounds in the Notice of Appeal. The Commissioner was given an opportunity to reply to these submissions and did so on 29 July 2024.

42. In paragraph 3 of the covering email to his Closing Submission the Appellant summarised his position more forcefully as follows:

> '[The Commissioner] is attempting to introduce a bold, novel doctrine into Hong Kong tax law. To summarise [the Commissioner's] claim in the broadest: A settlement or termination payment based on a settlement or termination agreement between an employee who has never held permanent residency in Hong Kong and at the time of entering into the agreement was not a resident of Hong Kong with a non-Hong Kong based company about an employment relationship outside of Hong Kong that gets paid outside of Hong Kong in a currency other than Hong Kong dollars is fully taxable in Hong Kong as long as sometimes in the past the employee was a tax resident of Hong Kong.'

Relevant statutory provisions and case law

43. Section 8(1) of the Ordinance provides that: -

> *'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 … any office or employment of profit …'*

44. Section 9(1)(a) of the Ordinance defines income from any office or employment to include: -

> *'any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others …'*

45. Section 11B provides that the assessable income of a person in any year of assessment shall be the aggregate amount of income accruing to him from all sources in that year of assessment.

46. For the purpose of section 11B:

(a) section 11C provides that a person shall be deemed to commence or cease, as the case may be, to derive income from a source whenever and as often as he commences or ceases to hold any office or employment of profit;

(b) proviso (ii) to section 11D(b) further provides that any payment made by an employer to a person after that person has ceased to derive income which, if it had been made on the last day of the period during which he derived income, would have been included in that person's assessable income for the year of assessment in which he ceased to derive income from that employment, shall be deemed to have accrued to that person on the last day of that employment.

47. The proviso (ii) to section 11D(b) is the reason the Commissioner determined that the LTI Payout received should be calculated in the 2017/18 year of employment, even though the money was only received in 2019 long after the Appellant had ceased to be employed in Hong Kong.

48. In Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74, Ribeiro PJ held (at paragraph 14) that whether a payment is chargeable to Salaries Tax turns on the construction of section (8)(1) of IRO. The test is whether such payment is '*income ... from ... any office or employment of profits*'.

49. The following principles were set out in Fuchs: -

(a) Income chargeable under section 8(1) is not confined to income earned in the course of employment but embraces payments made (i) in return for acting as or being an employee; (ii) as a reward for past services or (iii) as an inducement to enter into employment and provide future services. (Paragraph 17)

(b) It is crucial to ascertain the purpose of the sum and should not be distracted by its label. If a payment, viewed as a matter of substance and not merely of form and without being *'blinded by some formulae which the parties may have used'*, is found to be derived from the Appellant's employment in the abovementioned sense, it is assessable. This approach properly gives effect to the language of section 8(1). (Paragraph 17)

(c) Where a payment falls within the operative test, it is assessable and the fact that, as a matter of language, it is described in some other terms, such as 'compensation for loss of office', does not displace liability to tax. The applicable test gives effect to the statutory language; other possible characterizations of the payment are beside the point if, applying the test, the payment is 'from employment' (Paragraphs 18 and 22)

(d) A payment that is concluded as being 'for something else' does not come within the above test and is not assessable. Insofar as it is contended that a payment was not made in return for a Appellant 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. A conclusion may be reached in the 'abrogation' examples 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 case. The test remains that of the purpose of the payment at the relevant time. (Paragraphs 18 and 22)

50. The Court of Final Appeal in Commissioner of Inland Revenue v Poon Cho Ming, John (2019) 22 HKCFAR 344, reaffirmed the principles and approach set out in Fuchs.

51. Other cases and decisions of this board were cited by the Commissioner. However, these all turned on their facts.

52. At the hearing, the Appellant also made a brief reference to Commissioner of Inland Revenue v Elliot, Stewart William George [2007] 1 HKLRD 297. (In his Closing Submissions, he made a further submission based on this case, which the Board has not allowed because it was a new ground of appeal.) In that case, the Court of Appeal held that a payment of US$11 million under a termination agreement to the taxpayer where in exchange the taxpayer gave up the rights to certain bonus units was not taxable.

Consideration of the Appellant's Grounds of Appeal

53. The Appellant's principal ground of appeal is that the payment of the LTI Payout was an agreed termination payment of his Company A Contact and not his Company H Contract. ('Termination Payment') Company A had said that they would offer him another position but had not done so. There had then been negotiations to terminate the contract and the parties had reached the Termination Agreement.

54. The Appellant submitted that the reason for referring back to the CC LTI to calculate the Termination Payment was that he 'preferred an alignment of settlement payment and economic performance of the other party as a way to extract a higher settlement amount based on expected value considerations. As such, rather than a smaller fixed lump sum payment [he] agreed to a higher expected value Termination Payment based on the economic performance of the other settlement party.'

55. In paragraphs 6 and 15 of his Notice of Appeal the Appellant stated that the Termination Payment was based on the future performance of CC CHINA. The reason the CC LTI plan was referred to was that it did not make sense to re-invent the wheel to develop a bespoke method of calculation. The CC LTI plan was administered by a third party (EY) and was therefore neutral and not open to be manipulated. The agreement to use the CC LTI plan had the benefits of low administration costs for Company A and certainty for the Appellant that the calculations were neutral.

56. The Appellant further submitted that the Termination Agreement includes settlement and waiver and a non-disparagement clause which was not present in the

Company A Contract. There was therefore an additional restriction imposed on him by the Termination Agreement.

57. There is evidence in a letter from EY to the Commissioner dated 29 June 2021 that Company A tried to identify a job opportunity for him within the group. The letter states no opportunity could be identified and there were then discussions with the Appellant over the official termination of the Company A Contract. Company A and the Appellant negotiated and agreed the Termination Agreement. EY stated that the payment was discretionary and on top of what Company H or Company A were obliged to pay.

58. EY also stated in the same letter that neither of Company H nor Company A were in breach of any terms of the original employment contract with the Appellant. The Board does not place much weight on this latter statement in itself because, as the Appellant submitted, they are unlikely to admit any breach. Nor was this a matter which EY would necessarily have knowledge of.

Consideration by the Board

59. The Board accepts that an employer may make a termination payment as part of a final termination agreement even if not directly related to the employee's employment. This can be done for a number of reasons, including to achieve a peaceful departure and to agree additional terms, such as a non-disparagement clause. For management level employees, these discussions may well not include any overt threat of legal action.

60. In this case, there is the additional feature, not present in the other cases cited by the Commissioner, that the Termination Agreement was dated almost a year after the Appellant left Hong Kong. The Termination Agreement was also with a non-Hong Kong company and governed by the law of Country G.

61. All of the above factors are all in favour of the Appellant's case that the Termination Payment should not be taxable in Hong Kong.

62. However, the question this Board has to ask itself under Section 8 of the Ordinance is: was the Termination Payment *'income arising in or derived from Hong Kong from … any office or employment of profit'* or, was it as the Court of Final Appeal put it in Fuchs, *'for something else'*?

63. The fact the Termination Payment was paid by Company A is not a directly relevant factor because Section 9 makes it clear that the payments may come from others.

64. The starting point for consideration is the terms of the Termination Agreement itself.

65. Clause 14 of the Termination Agreement specifically states that the Termination Agreement 'contains the entire understanding of the Parties with respect to the subject matter hereof.' The parties have therefore agreed that the Agreement sets out the

terms which have been agreed by them.

66. Clause 2 of the Termination Agreement provides (with emphasis added):

> 'In **deviation** from the plan conditions of the CC LTI, **the payment entitlement from the plan does not expire upon conclusion of this termination agreement**. **You remain entitled to payment** with the target amount of EUR 44,444.44 **accumulated up to the exemption date (30 November 2017**). Payment will be made in accordance with the plan conditions after the plan term of the Company A Long Term Incentive.'

67. The highlighted wording shows:

(a) The payment was a deviation from the CC LTI plan conditions that he would lose his entitlement under the Termination Agreement;

(b) The payment entitlement that had accrued (or accumulated) would not expire;

(c) The Appellant would **remain entitled to payment**;

(d) The amount was calculated up to his last day of employment in Hong Kong.

68. The wording of the Termination Agreement is clear. Subjectively, the Appellant may, as he submitted, have seen this agreement as a simple way to maximise his payment by using the Company A Group's performance to make the calculation using the pre-existing CC LTI as a base.

69. However, objectively, the Appellant is under the Termination Agreement quite clearly agreeing to receive payment that had accrued (or, accumulated, to use the wording in the translation of the Termination Agreement) during his employment in Hong Kong. The wording that the Appellant would 'remain entitled to payment' makes this clear. The payment actually made to the Appellant was specifically calculated based on the time he had been a member of the CC LTI plan, ie from April 2016 to November 2017. The Board does note that there appears to be a change in that CC CHINA is given 100% weighting whereas the grant letter gave CC CHINA a weighting of 70% and CC JAPAN a weighting of 30%. There is no evidence to explain this change. However, the wording of the Clause 2(1) of the Termination Agreement makes it clear, the Appellant was being paid what he was entitled to for the period April 2016 to November 2017.

70. One issue before the Board has been whether the Appellant had somehow lost the entitlement to a payment under the LTI program when his employment in Hong Kong terminated. The wording to the Termination Agreement specifically states the payment is a deviation from the plan but also states the Appellant would remain entitled to payment. The Commissioner in his letter of 29 July 2024 stated it was the Commissioner's case that the Appellant had not lost his entitlement. The letter from EY to the

Commissioner referred to in paragraph 37 above suggests he had lost the entitlement to the payment. EY stated that the payment was discretionary and on top of what Company H or Company A were obliged to pay. It is not necessary for the Board to determine the point. The wording of the Termination Agreement is clear that both the Company A and the Appellant have agreed that the Appellant is to be paid an amount that had accrued during his employment in Hong Kong.

71. The Board appreciates that Clause 10 of the Termination Agreement provided for settlement and waiver and that the Clause 12 provided for good conduct. While these are indicia to show the Termination Agreement was made to resolve any current or future disputes (even if not articulated), the fact remains the basis for the LTI Payout was directly stated in the Termination Agreement to payment of entitlement that had accrued (or accumulated) when the Appellant was employed in Hong Kong.

72. The LTI Payout was therefore 'derived' from the time the Appellant worked in Hong Kong and is subject to tax under Section 8(1).

73. For completeness, as set out above, the Board also deals briefly with two new issues raised in the Appellant's Closing Submissions:

(a) It does not matter that the Company A group for which the LTI Payout was calculated (CC CHINA) was based outside Hong Kong. The Appellant's employment contract was in Hong Kong and payment had accrued under that contract. Nor does it matter that the Target Factor[9] accumulates over the full period. This was part of the design of the plan. Again, the Appellant's employment contract was in Hong Kong and payment had accrued under that contract.

(b) The Appellant relied on CIR v Elliot (cited above) to argue that at the date of termination of his agreement, the value of the CC LTI was zero on the basis it was a contingent right. The decision in CIR v Elliot also does not assist the Appellant. In that case, the taxpayer gave up the right to payments under his agreement in return for a lump sum. In this case, the taxpayer received the amount that accrued under his employment agreement. The fact that it was a contingent amount when he left Hong Kong is not relevant. The amount was calculated and paid subsequently under an agreement that referenced back to his employment in Hong Kong.

Conclusion and Disposition

74. In conclusion, the Board determines the LTI Payout was derived from the Appellant's employment in Hong Kong and is chargeable to Salaries Tax in the year of assessment 2017/2018.

[9] Performance factors used to calculate the LTI Payout as shown in paragraph 32 above.

75. The Board dismisses the Appeal and confirms the Additional Salaries Tax Assessment.

Costs

76. The Commissioner did not seek costs. The Board does not consider this a case where the Appellant should be ordered to pay costs. There will be no order as to costs.

77. Finally, the board thanks both the Appellant and the Commissioner's representative for their measured and well-argued submissions.