Case No. D11/19

Profits tax – restricted shares scheme under employment contract – employment terminated due to redundancy – restricted shares released pursuant to settlement agreement – payment paid to appellant in assisting employer's litigation – whether value of restricted shares and payment for assisting employer's litigation income from appellant's employment – sections 8, 9, 11B, 11C, 11D, 68(4), 70 of the Inland Revenue Ordinance (Chapter 112) ('IRO')

Panel: Lo Pui Yin (chairman), Robin Gregory D'Souza and Shun Yan Edward Fan.

Dates of hearing: 30-31 August 2018.
Date of decision: 23 August 2019.

The Appellant ('A') entered into an employment contract ('Employment Contract') with his employer, Company B ('B'), providing A with the following benefits: (1) base salary; (2) guaranteed bonus (in cash and/or in shares/cash under restricted share plan and in the form of restricted shares released on the condition that A had not resigned or been dismissed on the date the restricted shares were due to be released); (3) carried interest scheme (covering those investments transacted by A and his team) and (4) discretionary bonus scheme (determined at the sole discretion of B, which might be delivered in cash and/or in shares/cash under D's restricted share plan). As part of his guaranteed bonus for 2010 and 2011, A was granted restricted share award in Company D ('D') for the years of 2010 ('2011 Shares') and 2011 ('2012 Shares').

In 2013, B informed A that his employment would be terminated on redundancy. The parties went into negotiation and came into agreed terms ('Termination Agreement'), including: (1) B would treat A as good leaver and permit all remaining restricted shares previously awarded to A to vest on same terms; (2) any release of 2012 Shares would be conditional on A having not committed a breach of Termination Agreement; if A committed a breach, any unvested 2012 Shares would be forfeited and A would repay to B the cash value of any shares vested; (3) the 2011 Shares would continue to vest on the release dates; (4) subject to A providing reasonable assistance in respect of B's litigation with Company G ('G Litigation'), B would compensate A for time spent, pay reasonable and pre-approved expenses incurred (including legal expenses) and provide reasonable security support; (5) B would pay enhanced severance payment; (6) A would provide reasonable assistance in proceedings (including G Litigation) as required in relation to any matter with which A was dealing during employment; (7) B would make reasonable accommodation for A when he was requested to travel.

On diver dates, B filed 5 notifications of an employee who was about to cease to be employed in respect of A and reported income and information of the restricted shares released (with their reported values respectively being 'Sum A', 'Sum B1', 'Sum B2' and 'Sum C'). A also filed his tax return. Based on the tax return filed, the Assessor raised on A

Salaries Tax Assessment for 2012/13. A did not object to the assessment, which then became final and conclusive.

Based on the 3rd notification filed by B, the Assessor raised an Additional Tax Assessment on Sum A. A objected to the additional assessment on the ground that Sum A was not within the definition of income from employment; that Sum A was not a payment made for services but settlement of legal dispute; that the shares were granted as a severance package, and not in consideration for A's services as employee; that A was not employed by B to assist in G Litigation but operated as an independent consultant; that A's agreement to render assistance to B did not constitute a continuing employment; that the severance package was a payment in lieu or an account of severance of employment, which should not be chargeable to Salaries Tax; and that the said shares were transferred to A after the end of year 2012/13 (hence not taxable in the year 2012/13 regardless of whether it was taxable).

Based on the 4th notification filed by B, the Assessor raised an Additional Salaries Tax Assessment on Sum B1/B2 (together as 'Sum B'). A objected to the additional assessment in the same terms as above. In response, B provided certain information: (1) the 2011 Shares and 2012 Shares were vested in accordance with the Termination Agreement; (2) the number of shares awarded to A were at B's sole discretion; (3) the amount set out in the Termination Agreement was the agreed daily rate of compensation payable to A for time spent in G Litigation. A spent 4 days and the total amount paid to A was 'Sum D'.

The Assessor maintained the view that Sum A, Sum B, Sum C (being the sums derived from the restricted shares) and Sum D (payment of A's service in respect of G Litigation) should be assessed to Salaries Tax. A appealed to the Board.

Held:

Legal principles

1. Regarding whether a payment was income from any office or employment, the issue on appeal was whether each of Sum A, Sum B, Sum C and Sum D constituted income from A's employment. Income chargeable to Salaries Tax was not confined to income earned in the course of employment but embraced payments made 'in return for acting as an inducement to enter into employment and provide further services'. If a payment, viewed as a matter of substance and not merely of form, was found to be derived from the taxpayer's employment, it was assessable. The vital question was what was the 'substance of the bargain' made between the employer and taxpayer for the payments in question (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 and Poon Cho Ming John v Commissioner of Inland Revenue [2018] HKCA 297 considered).

2. A payment concluded as 'for something else' was not assessable. Examples included damages obtained in a suit for wrongful dismissal or settlement payment made in the suit, indemnity paid to employee who had purchase a

house under a housing scheme set up by the employer but who had then had to sell it at a loss when directed by the employer to work elsewhere in the country, and payment made to relieve employee's distress or to help with his home purchase (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 and Poon Cho Ming John v Commissioner of Inland Revenue [2018] HKCA 297 considered).

3. Insofar as payment made as consideration for an employee abrogating his rights under the employment contract, the test must always be: in the light of the terms on which the taxpayer was employed and the circumstances of the termination, was the sum in substance income from employment? If the answer was 'yes', the sum was taxable and it mattered not that it might linguistically be acceptable also to refer to it as compensation for loss of office. The test was not whether the employer had acted in breach in terminating the contract; it was of the purpose of the payment at the relevant time (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 and Poon Cho Ming John v Commissioner of Inland Revenue [2018] HKCA 297 considered).

4. In the context of payment made on termination of a contact of employment, the same consideration applied: what was the substance of the bargain between the employer and taxpayer for the payments in question or the purpose of the payment? If the employee was entitled to the payment under the contract of employment, then the purpose of the payment was in order for the employer to perform its obligations under the contract, and the payment was income 'from' employment. If the employee was not so entitled, then one must consider the purpose for which the employer made the payment (Poon Cho Ming John v Commissioner of Inland Revenue [2018] HKCA 297 considered).

Sum A & Sum B1

5. The 2011 Shares were unequivocally guaranteed in the Employment Contract, and Sum A and Sum B1 were contractual entitlements of A. The Termination Agreement was not a fresh bargain between A and B. Without the Termination Agreement for progressing of the vesting schedule, the 2010 Shares that remained unvested as at the date of the termination of A's employment would in effect simply have lapsed. Hence, Sum A and Sum B1 were income from employment and were chargeable to Salaries Tax.

Sum B2 & Sum C

6. Sum B2 and Sum C were derived from the 2012 Shares. The Employment Contract enabled the award of the 2012 Shares as part of a discretionary bonus but provided no guarantee of them. Sum B2 and Sum C, instead of being contractual entitlements under the Employment Contract, represented the value of shares that B released to A pursuant to the Termination

Agreement. The continuing release of the 2012 Shares pursuant to the Termination Agreement was not for something else, but in return for acting or being an employee or as a reward for past services. Hence, Sum B2 and Sum C were also income from employment and were chargeable to Salaries Tax (Poon Cho Ming John v Commissioner of Inland Revenue [2018] HKCA 297 considered, facts distinguished).

Sum D

7. A's contention that he was acting as an 'expert witness' or an 'independent consultant' was not borne out by any evidence. On the contrary, both A and B had an understanding that A was assisting in the capacity of a former employee. It was well-established that a payment would be taxable insofar as it was 'made in reference to the services the employee renders by virtue of his office, and it must be something in the nature of a reward for services past, present or future'. Hence the fact that assistance was rendered by A after termination of employment did not preclude the Board from holding against A's contentions regarding Sum D. Hence, Sum D was income from employment and was chargeable to Salaries Tax (Hochstrasser (Inspector of Taxes) v Mayes [1960] AC 376 considered).

Obiter

8. Even in the case of gratuity, a payment would still be chargeable if it was a reward from the employer (e.g. for past services) even though the employer was not obliged to pay it and thus the employee had no legal entitlement to it (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 and Poon Cho Ming John v Commissioner of Inland Revenue [2018] HKCA 297 considered).

Appeal dismissed.

Cases referred to:

Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74
Poon Cho Ming John v Commissioner of Inland Revenue [2018] HKCA 297
Hochstrasser (Inspector of Taxes) v Mayes [1960] AC 376

Stefano Mariani of Messrs Deacons, for the Appellant.
Wilson Leung, Counsel, instructed by Department of Justice, for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This Appeal was lodged by the Appellant/Taxpayer, Mr A, against the Determination of the Deputy Commissioner of Inland Revenue dated 29 November 2017 rejecting the Taxpayer's objection to the Additional Salaries Tax Assessments for the year of assessment 2012/13 raised by the Assessor of the Revenue and confirming the first Additional Salaries Tax Assessment for the year of assessment 2012/13 and revising the second Additional Salaries Tax Assessment for the year of assessment 2012/13 ('the Determination').

2. The Taxpayer's Notice of Appeal refers to three assessments. The first was dated 18 March 2014 showing additional net income of $2,214,269 with additional tax payable thereon of $332,170. The second was dated 22 January 2015 showing additional net income of $3,920,700 with additional tax payable thereon of $588,105. The third was also dated 22 January 2015 relating to an increase to additional net income of $5,551,288 with additional tax payable thereon of $832,693. The additional net income referred to in these assessments included the value of 'restricted shares' the Taxpayer's former employer had awarded and, after the termination of his employment, released to the Taxpayer at different times afterwards between 2013 and 2015 and a sum that the former employer paid to the Taxpayer for time spent in relation to his assistance in a litigation after he had ceased employment with the former employer. The Taxpayer contends in the Notice of Appeal that each of these assessments was excessive and unwarranted in fact and law, raising specific issues in respect of this contention. The Taxpayer also contends in the Notice of Appeal that each of these assessments was incorrect.

3. This Board held the hearing of this Appeal on 30-31 August 2018. Both the Taxpayer and the Revenue were legally represented.

4. The Taxpayer testified on oath before this Board and was cross-examined by the Revenue.

5. This Board has heard submissions from counsel of the Taxpayer, Mr Mariani, and counsel of the Revenue, Mr Leung. The main point in Mr Mariani's submissions is that the value of the 'restricted shares' released to the Taxpayer at different times after he ceased employment with his employer should not be chargeable to Salaries Tax because the sums representing the value of those shares were not income from the Taxpayer's employment within the meaning of sections 8(1) and 9(1) of the Inland Revenue Ordinance (Chapter 112) ('the Ordinance'). A separate point concerns the nature of a sum paid by the employer to the Taxpayer after termination of employment for what can be described as assistance he gave in relation to a then on-going litigation involving the employer.

6. In the sections of this Decision that follow, this Board shall set out the agreed facts and make reference to a number of documents the parties have produced before

this Board. Then this Board shall have regard of the Determination. Thereafter, this Board shall consider the Taxpayer's evidence and make findings of fact. Lastly, the submissions of the Taxpayer and the Revenue are considered in the light of the facts and evidence before this Board.

The Agreed Facts and the Documents

7. The Taxpayer has indicated through his legal representatives, his agreement to Facts (1) to (17) under paragraph 1 of the Deputy Commissioner's Determination. This Board finds these Agreed Facts as facts.

8. The Agreed Facts are:

(1) Company B ('the Company'), a company incorporated and carrying on business in Hong Kong, offered the Taxpayer a Position C, by a letter dated 27 May 2010 ('the Employment Contract'). The terms and conditions of employment, which were accepted by the Taxpayer on 31 May 2010, were as follows:

Basic salary

(a) The Taxpayer would be paid a base salary of $260,000 per calendar month.

Guaranteed bonus

(b) With respect to performance year 2010, the Taxpayer would be guaranteed a bonus of $11,700,000. The guaranteed bonus might be delivered in cash and/or deferred in the form of shares/cash, under the Company D Restricted Share Plan, at the sole discretion of the Company. Cash bonuses would be payable by March 2011.

(c) The guaranteed bonus in the form of restricted shares would be released on the condition that the Taxpayer had not resigned or been dismissed as a result of his gross misconduct on the date the restricted shares were due to be released.

Carried interest scheme

(d) The Taxpayer would be eligible for inclusion in the Carry Plan E, which would cover those investments transacted by the Taxpayer and his team. The details of the plan would be available for discussion with the Taxpayer and his eligibility for participation established within a few months.

Discretionary bonus scheme

(e) The Taxpayer would be eligible to participate in the discretionary bonus scheme which might operate from time to time, subject to the rules of such scheme established by the Company. The amount of such bonus (if any) was determined at the sole discretion of the Company, which would take into consideration the Taxpayer's performance, the performance of Group F ('the Group') and such other facts as the Company might determine.

(f) Bonuses might be delivered in cash and/or deferred in the form of shares/cash, under the Company D Restricted Share Plan, at the sole discretion of the Company. Cash bonuses would normally be paid by March of the following year. To be eligible for any award, the Taxpayer must be under employment on the distribution date. The Taxpayer would not be eligible for any other bonus scheme operated by the Group.

Notice period

(g) The employment could be terminated at any time by either party by giving three months' notice or payment in lieu after completing probation.

Post-termination restrictions

(h) The Taxpayer agreed that, to safeguard the Company's goodwill and name and to protect the Company's legitimate proprietary interests, he would be subject to certain non-solicitation and restrictive covenants, during a period of three months following the date of termination notice given by either the Taxpayer or the Company.

(2) (a) As part of his guaranteed bonus for the performance year 2010, the Taxpayer was granted a restricted share award of shares in Company D ('2011 Shares') under the Group F Share Plan. The details of the award were as follows:

Award date	Total shares subject to award	% of award which would vest	Vesting date
15-03-2011	72,023	33	15-03-2012
		33	15-03-2013
		34	17-03-2014

(b) As part of his bonus for the performance year of 2011, the Taxpayer was granted another restricted share award of shares

in Company D ('2012 Shares') under the Group F Share Plan 2011 with details as follows:

Award date	Total shares subject to award	% of award which would vest	Vesting date
12-03-2012	61,323	33	12-03-2013
		33	12-03-2014
		34	12-03-2015

(c) The share plans ('the Plans') included the following terms and conditions:

(i) Participation in the Plans was governed by the rules of the Plans and did not form part of the contract of employment of the participant (i.e. the Taxpayer in the present case).

(ii) The award would vest on the vesting dates specified, provided the participant remained continuously employed within the Group or fell within the scope of the good leavers provisions set out in the Plans.

(iii) Awards might be amended, reduced or cancelled by the Company D Remuneration Committee ('the Committee') at any time before the award vested. The Committee had the discretion to impose additional conditions on the awards.

(iv) If the participant left the Group before the vesting dates(s) as a good leaver, then subject to the approval of the Committee and the policy of the Company, the awards would vest in full on the vesting date(s) subject to the Committee's authority as mentioned in (iii) above. Good leaver reasons included injury, ill-health, disability, redundancy and sale of employing company or business.

(v) Where the rule of good leavers applied and the participant had entered into a termination agreement in connection with the cessation of the participant's employment, the awards would not vest until the participant had complied with, or was released from his obligations under, that termination agreement.

(3) By a letter dated 21 January 2013, the Company informed the Taxpayer that as a result of business restructuring, his employment would be terminated on the grounds of redundancy. The letter stated the following:

(a) The last working date and termination date would be 21 January 2013.

(b) A payment in lieu of 3 months' notice together with an enhanced severance payment of $467,500 would be made to the Taxpayer.

(c) The terms of the letter would be in full and final settlement of the termination of employment, and the Taxpayer would not bring any claims against the Company and other group companies.

(d) As far as the restricted shares granted to the Taxpayer were concerned, the Taxpayer would be treated as a good leaver, and the vesting of any unvested shares would be conditional on his compliance with the terms stated in the letter.

(e) The Taxpayer would assist the Company and any group company in relation to the litigation regarding the Company's investment in Company G ('the Company G Litigation'), including attendance at court and arbitration hearings in Country H and Country J until conclusion of the claims involved.

(4) The Taxpayer did not accept the terms offered by the Company regarding his termination of employment on 22 January 2013. He wrote to the Company on 28 January 2013 and requested the following:

(a) All restricted shares awarded to him prior to the termination of employment should continue to vest on the scheduled vesting dates in accordance with the terms of the Employment Contract.

(b) Ongoing safety support should be provided so far as he was willing to provide reasonable assistance to the Company in connection with the legal and regulatory proceedings in the Company G Litigation.

(c) A more appropriate amount by way of severance or an ex-gratia sum in compromise of all claims under the Employment Contract in light of his 2012 service and the 'Carry Plan'.

(5) The Taxpayer appointed Tanner De Witt, Solicitors ('TDW') to handle the negotiation that followed. The Company appointed

Mayer Brown JSM ('MBJ') to represent it. The parties exchanged correspondence in the process. A summary of the letters and emails involved has been agreed. Copies of the letters and emails, including a data access request ('DAR') made by the Taxpayer to the Company under the Personal Data (Privacy) Ordinance (Chapter 486), have also been provided to the Revenue.

(6) By a letter dated 20 June 2013 ('the Termination Agreement') issued to TDW, MBJ, on behalf of the Company, set out the revised terms and conditions regarding the Taxpayer's termination of employment with the Company. The Taxpayer agreed to the terms contained in the letter by signing on 21 June 2013, which was followed by the signing of the representative of the Company. The terms and conditions of the Termination Agreement included the following:

Restricted Shares

(a) On the basis that the Taxpayer's employment was terminated by reason of redundancy, the Company would treat the Taxpayer as a good leaver for purposes of the Plans and permit all remaining restricted shares previously awarded to the Taxpayer to vest on the same terms as stated in the letters awarding them to the Taxpayer.

(b) Any release of the 2012 Shares would be conditional on the Taxpayer having not committed a breach of any of the terms of the Termination Agreement, including the one that he should not claim against the Company in connection with the employment or the cessation of the employment.

(c) If the Taxpayer committed a breach of any of the terms of the Termination Agreement, any unvested 2012 Shares would be forfeited immediately and the Taxpayer would repay to the Company the cash value (i.e. that upon the date of vesting) of any shares that had vested in the period from the termination of the Taxpayer's employment to the date of the breach.

(d) The 2011 Shares would continue to vest on the release dates set out in the letter awarding them to the Taxpayer.

The Company G Litigation

(e) Subject to the Taxpayer providing reasonable assistance, as set out in the Termination Agreement, in respect of the Company G Litigation, the Company agreed to –

(i) compensate the Taxpayer for the time he spent in relation to the Company G Litigation from 21 January 2013 onwards (such compensation would be calculated at the rate of $12,692 per day and the Taxpayer would be compensated for four days of his time spent on the matter during the period between 22 January and 20 June 2013);

(ii) pay reasonable and pre-approved travel and accommodation expenses that the Taxpayer incurred in providing his assistance;

(iii) provide the Taxpayer with reasonable security support in the relevant location of the litigation, i.e. Country H and Country J; and

(iv) reimburse reasonable and pre-approved legal expenses for advice obtained by the Taxpayer which was directly connected with the Company G Litigation.

Enhanced severance payment

(f) The Company would pay the Taxpayer a total enhanced severance payment of $467,500.

The Taxpayer's obligations after termination of employment

(g) The Taxpayer would provide reasonable assistance in proceedings, etc., as required, in relation to any matter with which the Taxpayer was dealing during his employment or in relation to which the Taxpayer had relevant knowledge.

(h) The Taxpayer would provide reasonable assistance in relation to the Company G Litigation including attendance at court and arbitration hearings in Country H and Country J until the conclusion of all evidence required with respect to the claims or five years from the date of the Termination Agreement, whichever is earlier.

(i) For safety sake, the Company would make reasonable accommodation for the Taxpayer when he was requested to travel to Country H. If there was a credible threat to his safety, the Taxpayer was not required to travel to Country H and other permissible means of attending hearings, etc. would be considered.

Release by the Taxpayer

(j) The Taxpayer agreed and undertook –

(i) immediately to withdraw any outstanding DAR made, including the one already issued to the Company; and

(ii) not to issue similar DAR.

(k) Except for a claim to enforce the Termination Agreement, the Taxpayer agreed to release and discharge the Company and related parties from all claims, etc. in connection with the employment or the cessation of the employment, including any claims for carried interest, bonus, restricted shares under the Plans and any payments during employment or arising from cessation of employment.

(l) The Taxpayer would not conduct himself in any way inconsistent with having surrendered his authority to act on behalf of the Company and the Group, both internally and externally. He would not claim or indicate that he was employed by any group company after the termination date. But this should not prevent the Taxpayer from confirming that he was providing assistance to the Company in the Company G Litigation.

Confidentiality

(m) The Taxpayer agreed not to divulge or communicate to any person or company, etc., to use without authority, or to cause unauthorized disclosure of any trade secrets or other confidential information (as defined in the Termination Agreement) related to the Company or any group company.

(n) The Taxpayer and the Company would keep confidential the terms of the Termination Agreement and matters related to the employment and cessation of employment.

(o) Each party would not make inaccurate or defamatory statement about the other party.

(7) (a) On diver dates, the Company filed notifications by an employer of an employee who is about the cease to be employed in respect of the Taxpayer and reported the following:

	First notification	Second notification	Third notification	Fourth notification	Fifth notification
(i) Capacity in which employed:			Position C		
(ii) Date of cessation of employment:			22-01-2013		
(iii) Period of employment:			01-04-2012 – 21-01-2013		
(iv) Reason for cessation:			Redundancy		
(v) Income particulars -	$	$	$	$	$
Salary	2,661,290				
Leave pay	287,500				
Payment in lieu of notice	825,000				
Certain payments from retirement schemes	352,638				
Restricted shares released	-	1,794,581	2,214,468	3,920,700	1,579,820
	4,126,428				
		[Note (1)]	[Note (2)]	[Note (3)]	[Note (4)]

Notes

Details of the restricted shares released were as follows:

	Date of award	Date of release	Number of shares released	Market price on date of release	Reportable value	
				$	$	
(1)	12-03-2012	12-03-2013	21,175	84.75	1,794,581	
(2)	15-03-2011	28-06-2013	27,255	81.25	2,214,468	(‘Sum A’)
(3)	15-03-2011	17-03-2014	27,818	77.50	2,155,895	(‘Sum B1’)
	12-03-2012	12-03-2014	22,453	78.60	1,764,805	(‘Sum B2’)
					3,920,700	(‘Sum B’)
(4)	12-03-2012	12-03-2015	24,101	65.55	1,579,820	(‘Sum C’)

(b) The Company also informed the Assessor that, apart from the income reported in the notifications, the Taxpayer was made a severance payment of $467,500 in compensation for the involuntary loss of employment with the Company due to redundancy.

(8) The Taxpayer filed his Tax Return – Individuals for the year of assessment 2012/13 and declared total income being that derived from the Company for the period from 1 April 2012 to 21 January 2013 as follow:

	$
Income under employment and other benefits	4,126,428
Share awards	1,794,581
	5,921,009

(9) (a) The Assessor of the Revenue accepted that the severance payment of $467,500 should not be assessed to Salaries Tax. Based on the tax return filed, the Assessor raised on the Taxpayer the following Salaries Tax Assessment for the year of assessment 2012/13:

	$
Income per return	5,921,009
Less: Retirement scheme contributions	12,000
Net Income	5,909,009
Tax Payable thereon at standard rate (after tax reduction)	876,351

(b) The Taxpayer did not object to the assessment. It then became final and conclusive in terms of section 70 of the Ordinance.

(10) Based on the third notification filed by the Company, the Assessor raised on the Taxpayer the following Additional Salaries Tax Assessment for the year of assessment 2012/13:

	$
Additional Net Income –	
Sum A	2,214,468
Additional Tax Payable thereon at standard rate	332,170

(11) The Taxpayer objected to the additional assessment on the following grounds:

(a) Sum A was not within the definition of income from employment under section 9 of the Ordinance. It should not be subject to Salaries Tax.

(b) Sum A represented value of Company D shares transferred to him pursuant to the settlement of a legal dispute regarding the termination of his employment with the Company.

(c) The Company terminated the Taxpayer's employment on 21 January 2013. They disputed over various legal issues arising from the termination of employment. After certain negotiations, the Termination Agreement was signed by both parties.

(d) Pursuant to the Termination Agreement, the Taxpayer agreed to release and discharge certain legal claims. He also agreed to withdraw the DAR and undertake certain restrictive covenants.

(e) In exchange for the Taxpayer's releases and undertakings, the Company undertook to transfer the values of the shares to him.

(f) Payments received from settlement of legal disputes were not taxable employment income. Sum A was not a payment made for services but settlement of legal dispute.

(g) The shares were transferred to the Taxpayer after the end of the year of assessment on 31 March 2013. Regardless of whether Sum A was taxable, it was certainly not taxable in the year of assessment 2012/13.

(12) In correspondence with the Assessor of the Revenue, Deacons, on behalf of the Taxpayer, advanced the following contentions:

(a) The relevant shares were granted to the Taxpayer as a severance package pursuant to the Termination Agreement following the termination of the Taxpayer's employment with the Company. The shares were not granted by the Company in consideration for the Taxpayer's services as an employee but for his agreement in the Termination Agreement abrogate any claims he might have against the Company, and an undertaking to render assistance to the Company in the Company G Litigation.

(b) No part of the severance packet was 'from employment' and the relevant share values should not be chargeable to Salaries Tax.

(c) The Taxpayer was not employed by the Company to assist in the Company G Litigation. He operated as an independent consultant. The part of the Termination Agreement concerning the Company G Litigation unambiguously excluded the possibility of the Taxpayer being an employee of the Company.

(d) The Taxpayer's agreement in the Termination Agreement to render assistance to the Company did not constitute a continuing employment or a new employment.

(e) The settlement provided, by way of the severance package (i.e. the values of the vested shares), fresh consideration for what was in all respects of a new set of undertakings given by the Taxpayer, which bore no connection with the Employment Contract or any services he might have rendered thereunder and did not amount to a continuing or new employment with the Company.

(f) Under the Employment Contract, the Taxpayer had no contractual rights to the severance package. The severance package was not paid to the Taxpayer in consideration of any past or future services in the employment of the Company. It was a payment in lieu or on account of severance of employment, which should not be chargeable to Salaries Tax.

(13) Based on the fourth notification filed by the Company, the Assessor raised on the Taxpayer the following Additional Salaries Tax Assessments for the year of assessment 2012/13:

	$
Additional Net Income – Sum B	3,920,700
Additional Tax Payable thereon at standard rate	588,105

(14) Deacons, on behalf of the Taxpayer, objected to the additional assessment in the same terms as those stated in sub-paragraph (11) and (12) above.

(15) In response to the Assessor's enquiries, the Company provided the following information:

(a) The 2011 Shares and the 2012 Shares were vested in accordance with the Termination Agreement.

(b) The number of shares awards of 72,023 and 61,323 granted to the Taxpayer were determined at the sole discretion of the Company after taking into consideration a number of factors including the Taxpayer's performance and the performance of the Group.

(c) The amount of $12,692 as set out in the Termination Agreement was the agreed daily rate of the compensation payable to the Taxpayer for the time he spent in relation to the Company G Litigation. The Taxpayer spent four days and the total amount paid to him was $50,768 ('Sum D') (i.e. $12,692 x 4).

(16) (a) The Assessor maintains his view that Sum A and Sum B should be assessed to Salaries Tax, and Sum C, in the same nature of Sum A and Sum B and having not been assessed to Salaries Tax before, should also be assessed to Salaries Tax. Besides, the Assessor considers that Sum D, which was paid by the Company to the Taxpayer for his assistance in the Company G Litigation, was income derived from his employment with the Company in Hong Kong and should be chargeable to Salaries Tax as well.

(b) Accordingly, the Assessor takes the view that the second additional assessment for the year of assessment 2012/13 should be revised as follows:

	$
Additional Net Income –	
Sum B (already assessed)	3,920,700
Sum C	1,579,820
Sum D	50,768
	5,551,288
Additional Tax Payable thereon at standard rate	832,693

9. This Board has had produced before it the following documents from the Taxpayer and the Revenue:

(a) Employment Contract dated 27 May 2010;

(b) The Plans in respect of the 2011 Shares;

(c) The Plans in respect of the 2012 Shares;

(d) Letter of the Company to the Taxpayer dated 21 January 2013;

(e) Letter of the Taxpayer to the Company dated 28 January 2013;

(f) Correspondence exchanged between the Taxpayer/ Taxpayer's legal representatives and the Company between 22 January 2013 and 14 June 2013;

(g) The Termination Agreement *per* letter of MBJ dated 20 June 2013;

(h) The Taxpayer's Tax Return – Individuals for the year of assessment 2012/13 (with attachments);

(i) Employer's notifications filed by the Company;

(j) Correspondence exchanged between the Revenue and the Taxpayer/ Deacons, representing the Taxpayer; and

(k) Correspondence exchanged between the Revenue and the Company.

The Determination

10. The Deputy Commissioner considered that the issue he had to decide was whether Sum A, Sum B, Sum C and Sum D should be chargeable to Salaries Tax. He referred to the following 'relevant provisions' of the Ordinance: sections 8(1)(a), 9(1)(a), 11B, 11C(a), 11D(b) and proviso. He also referred to the judgment of the Court of Final Appeal in Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74.

11. The Deputy Commissioner considered Sum A, Sum B and Sum C together on the basis that they were values of the shares awarded to the Taxpayer in the course of his employment with the Company in Hong Kong. He regarded Sum A and Sum B1 to be values of part of the shares granted to the Taxpayer, as part of the guaranteed bonus for the performance year 2010, in March 2011, which subsequently vested in the Taxpayer. He also regarded Sum B2 and Sum C to be values of part of another lot of shares granted to the Taxpayer, as part of the bonus for the performance year 2011, in March 2012, which were also subsequently vested in the Taxpayer. He believed that he was justified in treating Sum A, Sum B1, Sum B2 and Sum C in this way since the Employment Contract provided for the payment of a guaranteed bonus to the tax payment as an inducement for the Taxpayer to enter into the employment. Thus the bonuses paid for the Taxpayer's performance in the years 2010 and 2011 were rewards for the Taxpayer's services and paid to the Taxpayer pursuant to his entitlement under the Employment Contract. As a result, Sum A, Sum B and Sum C were considered to be the Taxpayer's income from employment and derived from his employment with the Company in Hong Kong and should be chargeable to Salaries Tax.

12. The Deputy Commissioner rejected the Taxpayer's claims that Sum A, Sum B, Sum C and Sum D were not income from employment but payment for settlement of his legal dispute with the Company and consideration for his releasing the Company from the claims that he might have against the Company and his undertaking to render assistance to the Company in the Company G Litigation, pursuant to the Termination Agreement. The Deputy Commissioner referred to the correspondence between the Taxpayer's side and the Company in the negotiations that led to the conclusion and the terms of the Termination Agreement, and considered that the nature of the 2011 Shares and the 2012 Shares released to the Taxpayer after the cessation of employment, being bonuses payable to him, did not change because of the Termination Agreement; they were income from employment when they were granted to the Taxpayer. The Deputy Commissioner regarded the vesting of the 2011 Shares and the 2012 Shares in the Taxpayer or not and the dates on which they vested only affected the accrual of the income to the Taxpayer and the time of the accrual, but not the nature of the income. The Deputy Commissioner noted that the Taxpayer, in entering into the Termination Agreement, did not surrender or forgo any pre-existing contractual rights. The Deputy Commissioner further referred to the Plans and pointed to the provision in the Plans that in the case of a good leaver and where a termination agreement had been entered into, the awards would not vest until the departing employee had complied with the

terms of the termination agreement, before taking the view that the requirement of the Termination Agreement that the Taxpayer must comply with its terms before the 2012 Shares could vest in him (while the 2011 Share would vest in him unconditionally) did not constitute a breach of the Employment Contract by the Company or loss of contractual rights under the Employment Contract by the Taxpayer. The Deputy Commissioner furthermore did not regard the Taxpayer's withdrawal of the DAR to be extraordinary in the actual circumstances. Rather he considered that to be part of the general release agreed upon settlement of the Taxpayer's claim for proper release of the relevant shares and did not affect the nature of Sum A, Sum B and Sum C as income from employment.

13. The Deputy Commissioner considered that Sum D, being the total remuneration paid by the Company to the Taxpayer for his 4-day assistance in the Company G Litigation after the termination of the employment, arose from the Taxpayer's employment with the Company. The Deputy Commissioner noted that the Taxpayer's assistance was required because he had handled and was responsible for the Company G case when he was in employment; and that such assistance was the performance of some follow-up work after cessation of employment. The Termination Agreement's terms indicated that the scope of assistance was limited to matters the Taxpayer had handled before or matters he had relevant knowledge of because of the employment and that he was to provide the assistance in the capacity of a former employee of the Company. The Deputy Commissioner thus considered that Sum D had its source from the Taxpayer's employment with the Company in Hong Kong and was his income from the employment chargeable to Salaries Tax.

14. The Deputy Commissioner held that although Sum D was a payment made by the Company to the Taxpayer after he had ceased or been deemed to cease to derive income, proviso (ii) to section 11D(b) of the Ordinance applied since if Sum D had been made on the last day of the period during which the Taxpayer derived income, i.e. 21 January 2013, as it was remuneration paid for the Taxpayer's services in his 4-day assistance in the Company G Litigation and thus income from employment, it would have been included in the Taxpayer's assessable income for the year of assessment 2012/13, in which the employment ceased. The result was that Sum D was deemed to have accrued to the Taxpayer on the last day of the employment, which was 21 January 2013 and fell within the year of assessment 2012/13 and therefore should be assessed in the year of assessment 2012/13 in accordance with section 11B of the Ordinance.

15. The Deputy Commissioner also held that by operation of both section 11B and proviso (ii) to section 11D(b) of the Ordinance, Sum A, Sum B and Sum C were deemed to have accrued to the Taxpayer on 21 January 2013 notwithstanding that they were regarded as payments made by the Company to the Taxpayer after the cessation of the employment. Therefore Sum A, Sum B and Sum C should be assessed in the year of assessment of 2012/13.

16. Finally, the Deputy Commissioner endorsed the computations of the Assessor of the Revenue in the inclusion of Sum C and Sum D in the second additional assessment for the year of assessment 2012/13 and therefore he not only confirmed the first Additional Salaries Tax Assessment for the year of assessment 2012/13 but also revised the

Second Additional Salaries Tax Assessment for the year of assessment 2012/13 in accordance with the Assessor's computations.

The Taxpayer's Testimony

17. The Taxpayer provided this Board with a witness statement that he had verified as truthful. He was examined orally by Mr Mariani. During the examination in chief, he stated that he was born in Country R and moved to Hong Kong in 2006 and went to work with the Company in 2010 as Position C. During cross-examination by Mr Leung, he expanded on his educational and work background, which included attending law school at University K and working in a law firm in City L. He was first employed in finance in 2000 and this employment brought him to private equity in Asia. Then from 2008 and 2010, he was the CEO of his own private investment firm.

18. The Taxpayer was asked during examination in chief about his responsibilities at the position of Position C. He stated in his witness statement that it was a very senior investment management role and in answer, he elaborated that he was responsible for the Company's private equity investment business for Asia. This meant he managed and was responsible for a team of executives that invested the capital of the Company's group into private equity situations, primarily by taking minority equity investments in different businesses. He often, as a result, would serve in the board of directors of those businesses and in general would advocate for creation of value for the Company's group's investment.

19. The Taxpayer was cross-examined on the Employment Contract. He agreed that he would not have accepted the job if what he would receive was the 'base salary' and the amount of HK$780,000 (said to be a 'signing bonus') stated on the Employment Contract. He agreed that he would not have accepted if there was not a 'carry plan'. He stated that for a Position C of a private equity business, having a salary alone without a 'carry plan' would not be the 'industry standard'.

20. The Taxpayer had explained during examination in chief the 'carry plan' in the Employment Contract. He stated that in private equity investing, the most meaningful form of compensation was to participate in the investment, or having a share of, the investment profits that one generates from the investment activity. He also stated that he joined the Company in 2010 partly because of the commitment that there would be a 'carry plan' and that he would be participating in meaningfully as the leader of the Company's Asia business. However, during the course of the employment, the Company and its group seemed to have changed their mind and had not put in place a 'carry plan'. He found that to be unfair. He did not consider that this matter to have been settled.

21. The Taxpayer was cross-examined on the provision on the Employment Contract for 'guaranteed bonus' for the performance year 2010. He answered that he understood this to be a specified amount he would receive for a 'performance year' (at the length of a calendar year) associated with 2010. He was referred to the nature of guaranteed bonus in the Employment Contract, namely partly in cash and partly in restricted shares that would be released upon satisfaction of specified conditions. The combination was the

decision of the employer, though the employee would prefer all cash because the shares were subject to vesting (which presented a risk of the employee actually not receiving them). He recalled that the cash part was paid by deposit into his bank account and a vesting timetable was provided for the shares part.

22. The Taxpayer was also cross-examined on the provision on the Employment Contract for 'discretionary bonus', which he explained would be applicable to 2011, 2012 and beyond. He further explained that it was 'customary' for a 'good performer' to receive a bonus for some amount and in fact he did receive on average a bonus of about HK$10 million or US$1.3 million in 2010 and 2011. He believed that his performance during his time with the Company was of a very high standard, having managed a highly efficient and productive team; it was distinguished service with the Company. He stated that this was evidenced by the performance appraisals he got.

23. The Taxpayer was cross-examined on the standing instruction he gave to Company S regarding the shares he was entitled to pursuant to the vesting timetable and the associated conditions. He explained that the standing instruction was set up by him to sell the shares in the event that they became unrestricted. That was the event when he got control of the shares. Up until that point he did not have control of them.

24. The Taxpayer was asked during examination in chief about an investment that was completed during his employment with the Company, which involved a company named Company G. He stated that this was a business sourced from the Company's Country H team. In relation to Company G, he discovered certain accounting irregularities in it, which gave him concerns over the US$60 million investment made into it, and began on behalf of the Company's group to advocate for recovery of that investment.

25. The Taxpayer continued in examination in chief that in 2013, he was informed that the Company's group had decided to close down its principal investment business in Asia and that he and his team members were being made redundant, terminated effectively and immediately. That was not much of a surprise since in the previous year he had made members of his team in Country H redundant and had reduced the size of the team in Hong Kong. What surprised him was the abrupt way the Company proposed to sever ties. During cross-examination, he confirmed his employment was terminated because of redundancy and not of resignation or having been disciplined or having been dismissed for cause. Also, he stated that he felt aggrieved about the timing of the redundancy because he was 'given zero' in the absence of the usual performance appraisal despite the full year's work he had done in 2012.

26. The Taxpayer stated that he was offered certain terms by the Company in respect of the termination of employment but he rejected them because he believed they were less than what had been offered to his colleagues in previous occasions. He believed that the offered terms involved additional restrictions and undertakings on his part that were not in his employment contract. One such restriction/undertaking involved requiring him to provide satisfactory assistance to the Company's group with respect to litigation concerning Company G. Another such restriction/undertaking involved excluding him from the management business of two companies named Company M and Company N respectively.

The Taxpayer stated that that restriction seemed a punitive step and overreach on the part of the Company. He thought that he could continue to interact with those companies as a non-executive director or senior adviser, or a chairman of an overseas subsidiary. Additionally, he believed that the terms offered were also less than what he deserved or should have received. As a result, he sought legal advice and after speaking to a few law firms, he engaged TDW to advise him of his rights and to help with advocating for a better resolution, including the possibility of seeking that by litigation. His approach was to be aggressive since the amounts involved were 'very meaningful amounts'. Although TDW told him of the discretion the Company and its group had on the vesting schedule of restricted shares and also that his case regarding the 'carry plan' was very weak, he insisted on continuing advocacy and he believed that they did put forward the strongest position. TDW also advised and the Taxpayer accepted that a DAR be made; he understood that to be a way of exerting leverage for a favourable settlement. From memory, the Taxpayer recalled that the Company wanted the DAR be withdrawn and he and his solicitors did not do so. In the event, the final settlement reached provided that he would withdraw the request.

27. Regarding the final settlement, the Taxpayer stated that he agreed to it since there had been five months of strain and he received advice that he did not have good prospects in litigation; he wished to move on, as opposed to incurring time and legal expenses to have hostilities with the Company and its group for a period of years. And he considered the settlement to be acceptable though not what he had hoped for.

28. The Taxpayer was asked about the Company G Litigation. He commenced while he was with the Company an investigation on alleged misappropriation of the investment made into that company and also action to recover the alleged misappropriated sums. Actions were taken at the company board level of Company G and its related entities. The recovery action(s) became a multi-jurisdictional litigation and enforcement action involving Country H, Country P, and Country J. Legal action in Country Q had also been contemplated. In this connection, threats had been made against him and the security assessment conducted suggested that it would not be safe for him to travel to Country H. And on an occasion when he had had to travel to Country H, robust security arrangements were made to protect him. After the settlement was signed, he continued to be involved in the Company G matter and that involved him going to Country J for a bit less than a week waiting to provide and providing witness testimony in arbitration proceedings held there.

29. The Taxpayer testified that he was at the time of the hearing the CEO and Position C of a private equity firm that he and former colleagues from the Company formed in December 2013. Part of the work the firm did for a period of time in fact was business consulting for Company M and Company N. It was not part of the business of the firm or himself to be a litigation consultant.

30. The Taxpayer confirmed that in relation to Sum D, the per diem consulting fee on the Company G litigation, he had not paid tax for it in any jurisdiction.

31. The Taxpayer was recalled to give further evidence. He confirmed receipt of the restricted share award statement dated 31 March 2011 and the restricted share award statement dated 7 June 2012. He also referred to and explained a confirmation document

sent to him after restricted shares were released to him and his instructions regarding them had been followed and that document stated the actual price and thus the actual value of the shares he received. He further confirmed that he was paid a sum in respect of 4 days he spent in preparing his written statement in relation to the Company G Litigation on a date after the Termination Agreement was signed and that later he spent 5 working days in Country J in relation to the Company G Litigation, in respect of which he was also paid. He was cross-examined as to whether he had received the Group F Share Plan and his answer was that he asked about it, he was supplied with it, but no one took him through it and he did not read it. He was asked again about the guaranteed bonus and he confirmed that the amount of the guaranteed bonus stated in the Employment Contract was a significant part of the compensation package. He was also asked again about the term in the Employment Contract regarding the 'carry plan' and he confirmed that that term was the only term regarding the 'carry plan' in respect of his employment with the Company and there was nothing else in writing about participation in the 'carry plan'.

32. This Board accepts the Taxpayer's testimony as credible. This Board will consider the Taxpayer's testimony as part of the body of evidence, which includes the responses made by the Company or its group to the enquiries of the Assessor of the Revenue, in making its findings of fact.

The Submissions

33. Section 8(1) of the Inland Revenue Ordinance provides that:

> '*(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) an office or employment of profit ...*'.

Relevantly, section 9(1)(a) defines that:

> '*(1) Income from any office or employment includes: (a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others ...*'.

34. The Taxpayer's legal representative, Mr Mariani, first asked this Board to consider Sum A, Sum B and Sum C, the liquidated proceeds of the restricted shares under the Plans, and whether they constituted income from employment within the meaning of section 8 and 9 of the Inland Revenue Ordinance:

(a) Mr Mariani indicated that the Taxpayer's burden of proof in his Appeal was to substantiate his case.

(b) Mr Mariani drew the attention of this Board to the distinction between the act of grant of the restricted shares (under which the 'bonus' was

awarded to the Taxpayer) and the vesting of those shares. It was only upon vesting that the Taxpayer got anything at all. Prior to the date of vesting, the person to whom the shares were granted had no beneficial interest whatsoever in them. He had a mere hope of being employed on good terms on the vesting date or otherwise having discretion exercised in his favour. He had nothing at all until the date of vesting.

(c) Mr Mariani referred to section 8(1), which states that income 'sourced' from employment is chargeable to Salaries Tax, and submitted that on the face of it, this does not refer to any capital sums. Then, in relation to section 9, he submitted that the drafting was broad enough to capture capital sums, such as employment related securities. Reading the two sections, he submitted that they are premised on the notion that there must be some sort of actual entitlement of some benefit or perquisite flowing from the payment and that the payment must be sourced from employment. And section 9(1)(d), which concerns share options, had no application in the Taxpayer's case, since in the scenario of restricted shares, it was not at the instance of the 'grantee' to decide whether or not to exercise the option; there was a pre-arranged vesting schedule. Therefore, he emphasized the distinction between grant and vesting and his submission that the Taxpayer had nothing upon grant and only got something upon vesting, so that the relevant point of taxation had to be the point of vesting. The grant conferred upon the Taxpayer a contingent right to the shares on the terms of the relevant plan and unless and until there was vesting in accordance with that plan, he had no reward, no asset and nothing of value. Thus, as regards the unvested tranches of the restricted shares as at the date of the termination of the Taxpayer's employment, he had nothing capable of being charged to Salaries Tax on the terms of sections 8 and 9.

(d) The Taxpayer was granted a restricted share award as part of his guaranteed bonus for the performance year 2010 (ie the 2011 Shares) and the shares so awarded were governed by the Group F Share Plan. Mr Mariani addressed this 'guaranteed bonus' in terms that this was neither guaranteed nor a bonus in substance because the way under which it (or the restricted shares part of it) was granted under the Group F Share Plan. Therefore, Mr Mariani submitted that the Deputy Commissioner was in error to assert that the clause in the Taxpayer's Employment Contract regarding the guaranteed bonus was tantamount to an unconditional promise that the vesting schedule of the 2011 Shares would vest irrespective of the termination of the employment in a good leaver scenario. Rather, the award of restricted shares was expressly subject to the Group F Share Plan, which stipulated that the Company's group had discretion to impose certain additional non-performance related conditions as conditions precedent to progressing the vesting schedule. Rules 5.2, 5.3, 9.2.4,

9.3.2, 15.6.2 and 15.6.3 of the Group F Share Plan were referred to. Hence the provision in the Employment Contract must necessarily be read with reference to the Group F Share Plan. And the Group F Share Plan was the 'contractual machinery' that controlled vesting of the restricted shares. What the Taxpayer got by virtue of the grant was a notional capital value in respect of the shares which could not be realized until vesting. And until vesting, there was no guaranteed economic reward at all.

(e) Mr Mariani also pointed to the shares portion of the 'guaranteed bonus' being restricted shares (ie shares subject to restrictions that were part and parcel of them). It followed that such 'guaranteed bonus' was not guaranteed at all in an economic sense. Whereas the contractual obligation arising to the Company to pay a 'guaranteed bonus' in cash and shares in such proportions as it saw fit was fully discharged by the grant of restricted shares, the vesting of the restricted shares was subject to the Group F Share Plan which bound only the Company's holding company. The Group F Share Plan was part and parcel of the economic and commercial conditions under which those shares were held. Neither the Employment Contract's provision on the 'guaranteed bonus' nor the certificate sent to the Taxpayer displaced the Group F Share Plan. So, 'guaranteed bonus' was limited to *grant* and did not entail guaranteed vesting; the entirety of the obligation was discharged by virtue of the *grant*. Vesting, on the other hand, was controlled by the Group F Share Plan. This made sense from a commercial point of view since the vesting provisions usually existed to ensure loyalty on the part of the employee both in relation to remaining in employment and in relation to leaving employment in good terms. Even though the 'guaranteed bonus' was of a specified sum, what was guaranteed was a grant of that specified sum and this stood to reason because the Company's group or holding company, a publicly traded company, could not be in a condition to guarantee that in relation to its shares. Hence the Taxpayer had no accrued entitlement to the vesting of the shares or the progression of the vesting schedule of the shares until such time as he complied with the conditions under the Group F Share Plan. And it would not be right to say that the Taxpayer was entitled to the specified sum at vesting as that would involve the Company or its holding company giving him either compensation in cash for any loss of value in the shares or giving him additional shares, and there was no indication of any mechanism for any one of those two.

(f) The Taxpayer was granted a restricted share award as part of his discretionary bonus for the performance year 2011 (ie the 2012 Shares) and the shares so awarded were governed by the Group F Share Plan 2011. The relevant clause in the Employment Contract referred directly to the Group F Share Plan 2011, whose relevant rules

(and Rules 2.4.1(iii), 2.4.2, 5.2.1, 5.7 were referred to) essentially replicated those in the Group F Share Plan. Mr Mariani said that they were materially identical for the purposes of the Taxpayer's Appeal. Mr Mariani stressed that the Company's group had the discretion, contractually and wholly unfettered, to decide whether or not to progress to vesting in a post-termination scenario even in a good leaver setting.

(g) Mr Mariani submitted that the Taxpayer, by reason of the provisions in the Plans, did not at any point after termination of his employment had any accrued right to the restricted shares that had been granted to him but had remained unvested as at 21 January 2013, being the date of the termination of employment. They were still subject to the Plans and vesting schedule. So he was not beneficially entitled to the restricted shares granted and no enforceable claims for them. On the other hand, the performance related to the bonuses was discharged by the grants of restricted shares. This was because the vesting of the restricted shares turned on a different set of covenants and undertakings not properly sourced in the Taxpayer's employment.

(h) Mr Mariani submitted that it was not for this Board to be concerned about whether the Taxpayer could have enforced in contract the entitlement to the restricted shares he was granted, notwithstanding the rule in the Plans (which were drafted by two reputable firms of solicitors) providing that an employee shall have no claim or right of action in respect of the exercise of discretion under the Plans even if it was unreasonable, irrational, etc. In fact, what the Taxpayer had been asked to do were not necessarily uncharacteristic of the post-termination covenants or undertakings that a highly paid employee, with first hand knowledge of an investment that had resulted in an expensive and painful litigation, might be required to undertake. As the Plans envisaged not only vesting from employment but also for a situation whereby additional non-employment related conditions might be imposed by the employer as a condition precedent to vesting, it would still be within the Plans to require a good leaver to do additional things not in the contract of employment.

(i) Mr Mariani referred to the Company's offer made at the time of the termination of employment on 21 January 2013, particularly the covenants that the Company purported to require of the Taxpayer, and submitted that it could not be said that at the time of termination of employment, the vesting of the restricted shares was a reward for past, present or future services in employment with the Company or its group, or otherwise for acting as an employee of them. Rather, the Company's position appeared to be that the restricted shares would vest if the Taxpayer did certain specified additional things for the Company and its group that were not employment related. So,

between the time in which the shares were granted and the time in which they would have vested, the Taxpayer had a purely contingent interest in the restricted shares subject to fulfilment of conditions that the Company or its group saw fit to impose. And such conditions related to the Taxpayer's conduct post-employment and had nothing to do with service of employment, or any legal obligation under the Employment Contract. After 21 January 2013, there was no employment relationship between the Company and its group and the Taxpayer.

(j) Mr Mariani referred to the instructions that the Company's group instructed Company S not to process the Taxpayer's instructions over the liquidation of a tranche of restricted shares vested in his post-termination of employment. He submitted this was due to the Company's group taking the view that the Taxpayer was not entitled to the continued progression of the vesting schedule and thus the vesting of that tranche of restricted shares. He also stated that the Company's group was entitled to do so under the Plans.

(k) Mr Mariani referred to the negotiations between TDW on behalf of the Taxpayer and MBJ on behalf of the Company and its group. He stressed that both sides were negotiating from positions capable of change in the course of such negotiation but with a view to litigate if it became necessary. The sands were shifting, so to speak. He suggested that the former employee and the former employer were effectively on a litigious footing because they could not, after the employment contract had determined, come to an agreement as to what their respective post-termination rights and obligations were. Hence none of the statements made in the correspondence should be read as if they were legally binding provisions. One particular example was the Taxpayer's statement in correspondence that he was willing to assist in the Company G Litigation. This statement, Mr Mariani said, should not be considered in isolation but rather as a part of a broader conversation involving other aspects of the dispute.

(l) Mr Mariani emphasized that the Termination Agreement reached after several months of correspondence between the solicitors of the two sides involved a set of conditions different from those in the Employment Contract and in the Company's offer. He referred to: (i) the general settlement of all rights, claims and demands being wide enough to cover the contingent right the Taxpayer would have in relation to the 'carry plan'; (ii) the undertaking not to interfere into the affairs of the investee companies, once proposed in the offer, now not pursued; (iii) the rendering of reasonable assistance in the Company G Litigation together with the such assistance being compensated by a per diem sum and being supported with reasonable security guarantee provided by the Company's group in case there

was a need to travel to Country H; (iv) the withdrawal of the DAR; (v) the confidentiality provision being extended to 'all matters' including the negotiations that led to the Termination Agreement with a particular definition of 'confidential information' (which was further than the common law obligation not to disclose trade secrets); and (vi) the withdrawal of threat of litigation in light of the Termination Agreement's operating in full and final settlement of any claims. Mr Mariani submitted that these matters were of sufficient value both to the Taxpayer and to his former employer and its group that they came to a mutual agreement in respect of them and the agreement did require the Taxpayer to do additional things, including the assistance in the Company G Litigation related to an important and very substantial investment. There was no question about the genuine nature of the exchange of consideration under the agreement from the two commercial entities involved. Hence the Termination Agreement was a fresh bargain between the Taxpayer and the Company and its group and an independent contract relating to matters that were relevant to a period in time in which the Employment Contract had gone entirely. The fresh bargain was the offer by the Company and its group to exercise its discretion to progress the vesting of the 2010 Shares and the 2011 Shares that were as of the date of the Taxpayer's termination of employment unvested and that was the primary cause for the Taxpayer being paid Sums A, B and C. There were before this Board contemporaneous signed documentary evidence in plain contractual language supporting the Taxpayer's case that the Termination Agreement, reached some 5 months after termination of employment, was a separate contract, it was a mutual settlement of claims, it had independent vitality, and the consideration that flowed from it was not consideration originally to which the Taxpayer was entitled under the Employment Contract but a fresh exchange of consideration. *The settlement was the relevant bargain*. He made clear that the above submissions did not suggest that the Taxpayer's undertaking to assist in the Company G Litigation was an abrogation of rights. The consideration of this separate contract was an abrogation of certain rights plus the Taxpayer agreeing and undertaking to certain additional covenants and obligations. The Taxpayer's undertaking to assist in the Company G Litigation was good consideration. The Taxpayer's cessation to pursue claim in respect of the 'carry plan' was an abrogation of a contingent right. He also pointed to a clawback clause in the Termination Agreement, which he underlined as a substantively different provision the breach of which would trigger a separate contractual claim against the Taxpayer, and submitted this would indicate the Termination Agreement as a wholly self-sustaining contract not parasitic on the Employment Contract. He also pointed to what the Taxpayer had got under the Termination Agreement that were said to be above and beyond anything contemplated in the

Employment Contract, particularly payment of an enhanced severance payment, an agreement to pay him a per diem compensation for his assistance in the Company G litigation, and the undertaking to provide personal security protection if he had to travel to Country H in relation to the Company G litigation. He also reminded that there was no suggestion that the settlement was being used as a cloak for tax avoidance. He also reminded that where the Taxpayer had, or genuinely believed that he had, a good claim against the Company for breach of the Employment Contract, and had appointed TDW to pursue it on a litigation footing, then his abandoning of the claim and withdrawing of the dispute under the settlement was an abrogation of rights.

Regarding Sum D, Mr Mariani submitted that this per diem payment made by the Company's group to the Taxpayer for his time in Country J in relation to the Company G Litigation was not reward for past services in employment or for acting as an employee. He underlined 'past services' because the Revenue no longer asserted that the Taxpayer was re-employed by the Company or its group. He submitted that the 'root contractual obligation' in this regard was from the Termination Agreement. There was no mention of the particular arrangement in the Employment Contract; it was not contemplated in the Employment Contract. The arrangement did not take the shape or form in which it was implemented until the Termination Agreement. The Taxpayer had never accepted that he had a legal obligation to assist in the Company G litigation. Matters of customary or best business practice or maintaining good relationship were all irrelevant to the determination of the legal question. The point was that this sum was separately and subsequently agreed as part of the settlement for the performance of a self-contained obligation that the Taxpayer was not required to do. The settlement established the quantum and the conditions of payment and hence it was the 'source'. Also, the fact that the Taxpayer was asked to give evidence in the arbitration in Country J with respect to matters that related to his employment with the Company was not relevant, for correlation would not imply causation. Also, by the same token, the computation of the payment as a function of the base salary did not imply causation or being 'sourced' from employment. In sum, the payment of Sum D was not from the Taxpayer's employment with the Company but as consideration for the separate undertaking in the Termination Agreement. And whether or not Sum D was chargeable for Profits Tax here was irrelevant.

35. The Revenue's representative, Mr Leung, made the following submissions-

(a) The statutory test to be applied was whether the sums came from the Taxpayer's employment. If so, they were chargeable for Salaries Tax.

If not, they were not. This Board must apply the statutory wording to the facts of this Appeal. To this end, this Board may be assisted by the formulae used in case law to describe the circumstances in which a payment is 'from the taxpayer's employment'. Mr Leung submitted that the formulae were guidelines to help this Board in the end to understand and apply the statutory test, so it was not necessary to fit the case into all the formulae. Also, this Board may be assisted by looking at how courts and boards had decided on similar questions previously but this exercise was not to compare how close the cases were to the facts of the Appeal. The purpose of the reading authorities was to find principle and not to seek analogies on the facts.

(b) Mr Leung noted from the grounds of appeal that this Appeal was argued in terms of whether the sums were from employment or not and there was no contention of apportionment. This Board would have to determine whether the sums were from employment (the Revenue's case) or not from employment and from something else (the Taxpayer's case). This Board would have to make a decision, on balance. Mr Leung also underlined the Taxpayer's burden of proof: The Taxpayer had to prove that the assessment appealed against was excessive or incorrect. The Revenue did not have to prove anything and could simply rely on the assessment as correct. If the Taxpayer failed to adduce any evidence to discharge the burden, or if his evidence was disbelieved, his Appeal should be resolved on the burden of proof by dismissal and upholding of the assessment. In the context of this Appeal, the Taxpayer had to identify and prove that the sums were paid for something else. And where the Taxpayer claimed there was a right which had been abrogated, he had to identify what the right was and then had to establish that the sum was paid for abrogation of that right. Mr Leung next made the point that one should not be distracted by 'labels', as in the end, it was whether the statutory test was satisfied. In the context of this Appeal, the 'label' would be the Termination Agreement (or what Mr Mariani had said in submission, the settlement agreement) and the 'general release' one sees in settlement agreements. Mr Leung emphasized this matter, stating that one should look behind any settlement agreement, look at the sums in question, and decide what was the effective cause of the payment; sometimes this would be a matter of fact and degree. Even if there had been negotiations and some horse trading or application of 'tactics', that did not change the proposition. Turning to the minutiae of the negotiations might not be too helpful. Mr Leung submitted that it would not make sense from the perspective of revenue law that a Taxpayer could avoid tax just by raising certain demands as part of horse trading and then giving them up and signing a settlement agreement with the employer after negotiations. Mr Leung further reminded this Board that the question for determination

was an objective question. Mr Leung furthermore asked this Board to apply common sense, particularly, commercial sense.

(c) Mr Leung submitted that if the Taxpayer had a contractual entitlement to the 2010 Shares and the 2011 Shares, then following the authorities, that would result in the dismissal of the Taxpayer's Appeal. But if this Board did not find that there was a legal entitlement, this Board would have to proceed to look at other aspects to decide on the purpose.

(d) Mr Leung turned to the Employment Contract and made these points about the 'guaranteed bonus' that was connected to the payment of Sum A and Sum B1: (i) The Employment Contract was a negotiated agreement; (ii) The part of the Employment Contract that said 'guaranteed bonus', by reference to (i), naturally meant 'guaranteed' and it was highly relevant that this was by the choice of the parties. The Taxpayer's evidence was that he expected to get the amount specified and certainly no less; (iii) With respect to the delivery of the 'guaranteed bonus', the relevant paragraph of the Employment Contract stated that the delivery of the shares part of the 'guaranteed bonus' was 'under' the Group F Share Plan as opposed to 'subject to' the Group F Shares Plan. And in so far as the paragraph mentioned 'at the sole discretion of the company', that concerned the discretion to choose the form of delivery of the bonus, including the form and portion of cash and/or shares; (iv) The part of the Employment Contract over 'guaranteed bonus' set out specifically circumstances in which the employee would not have the bonus released and none of those circumstances applied in the circumstances of the present Appeal; (v) The Group F Share Plan defined 'good leaver' in rule 9.2, which included redundancy, with the consequence or effect being that pursuant to rules 9.3.2, 9.4 and 9.5 of that plan, the restricted shares granted to an employee who was a 'good leaver' would vest in the normal way. Mr Leung added that 'good leaver' was not like a package of rights that one received. Rather the point was that virtually, by definition, a good leaver would normally expect the restricted shares granted to vest according to the timetable; (vi) Mr Leung submitted that even if the Company or its group were to decide against vesting in its 'absolute discretion' under the Group F Share Plan, the court would not only subject the exercise of discretion to the qualification that it must not be exercised irrationally, perversely, arbitrarily or in bad faith, notwithstanding the paragraph of the plan to the effect that the employee would have no claim or right of action even if the discretion was exercised unreasonably, etc., applying the 'red hand rule' and public policy, but also would place greater weight to the terms specifically chosen by the parties in the Employment Contract, and require very clear express words to exclude extreme events such as fraud, bad faith, arbitrariness from being actionable.

Thus the court would have no difficulty in granting the employee his entitlement under 'guaranteed bonus'. Authorities were cited in support; (vii) The Taxpayer's case was materially similar to (vi). Reference was made to the correspondence between the Taxpayer/TDW and the Company/MBJ. Mr Leung submitted that in the Taxpayer's case the Company and its group could not have properly withheld vesting in the circumstances based on the conditions that they sought to impose, which on the Taxpayer's case were considered unreasonable and even in bad faith. The 'guaranteed bonus' was an enforceable contractual entitlement.

(e) With respect to the 2012 Shares (which led to the payments of Sum B2 and Sum C), Mr Leung submitted that the Taxpayer had a contractual entitlement to the continued vesting of them. The 2012 Shares were awarded for the Taxpayer's performance in 2011 as part of the discretionary bonus for that year, which formed the majority part of his remuneration of that year. Mr Leung underlined that the Company had decided to award the Taxpayer a bonus pursuant to the 'discretionary bonus' provision of the Employment Contract before his employment was terminated. Adding to this the factors and related analysis concerning termination on the ground of redundancy and thereby being a 'good leaver', and over the validity of the Company or its group having sought to impose irrational, arbitrary or bad faith conditions, Mr Leung submitted that this Board should also hold that in relation to the 2012 Shares, the Taxpayer also had contractual entitlement to the continued vesting of those shares. It therefore followed that they and their value upon realization were from his employment.

(f) Mr Leung also submitted that if this Board were not with him on (d) and (e), particularly on the point claiming that the Taxpayer could have enforced his entitlement to the restricted shares in court notwithstanding an unreasonable, etc. exercise of discretion by the Company or its group under the Plans, this Board should still take into account his prima facie entitlement to or expectation to have them vested or of them being part of his contractual remuneration package. Such an entitlement or expectation was not nothing or worthless or mere opportunity. This was a matter that this Board could take into account in the overall assessment of the statutory test.

(g) Alternatively, Mr Leung submitted that this Board should take into account that the Sum A, Sum B1, Sum B2 and Sum C were for the Taxpayer's performance in 2010 and 2011; that his remuneration was mostly in the form of the bonus (which was delivered mainly in shares); and that the share based portion of the bonus was at least the same or even greater than his base cash salary. The Taxpayer's testimony confirmed, according to Mr Leung, the relevance of the

bonuses as part of the reason for him to accept the job offer of the Company. Mr Leung also referred to the manner in which the amount of the bonuses was determined to show that the bonuses were in return for acting or being an employee, in reference to the services rendered, or a reward for services for past, present or future. The Company's written answers to enquiries from the Revenue were in that regard neutral, or perhaps supportive of the Revenue's contention. Mr Leung further disagreed with Mr Mariani's emphasis on vesting, emphasizing that the grant or the reason for the grant of the shares being the Taxpayer's performance was relevant as a matter of common sense.

(h) Turning to the Termination Agreement or settlement agreement and claims of abrogation of rights based on it, Mr Leung reiterated the Taxpayer's burden of proof and submitted that the general release therein in light of the full and final settlement could not show that rights were abrogated; that the withdrawal of the DAR was part of the general release for clean break (and in any event, the Taxpayer's claim regarding the DAR did not fit well with the related correspondence and there was no evidence from TDW to substantiate the Taxpayer's claim that he was paid to withdraw the DAR); that there was no sufficient evidence to substantiate the Taxpayer's claim that he was paid so that he would abrogate any rights he had under the 'carry plan'; that the confidentiality provisions over post-termination confidentiality was also part of the general release and there was no sufficient evidence to substantiate the claim that he was paid to have those provisions included; that the matter over not interfering in the management of the two investee companies was not material as in the end there was no such restriction, meaning that the Taxpayer had not given up any rights and there was therefore no abrogation of rights; and that in respect of the assistance in the Company G litigation, the fact was that the Taxpayer was always willing to assist, subject to guarantees of his personal safety if he was asked to travel to Country H, and so it could not be established that he was paid the sums to include this assistance, and the Taxpayer's case was that he was paid separately for his assistance in the Company G litigation. Mr Leung also submitted that it would be the same if the Taxpayer's case was that the Company or its group paid for a package of rights or several rights put together. The Taxpayer still had to identify the package of rights and show, on balance, that the sums were paid for the package of rights. Mr Leung also submitted that the clawback provision in the Termination Agreement or the settlement agreement did not affect the payment of the sums since it essentially followed provisions in the Plans (so that it could not be said that there was an abrogation of rights) and that the parties had already contemplated that when an employee was a good leaver, he might have to sign a termination agreement.

(i) Mr Leung turned to Sum D. He referred to section 8 of the Ordinance and the statutory wording of 'from employment' and 'derived from employment'. Such language meant that the charge of Salaries Tax is not confined to income earned in the course of employment. Mr Leung submitted that the Taxpayer's case of Sum D coming from the 'something else' of a per diem consulting fee was not proved. The Company G matter was well connected with what the Taxpayer did when he was an employee of the Company. When the Company requested him to assist in the Company G Litigation at the time of termination of employment, he wrote in reply to express agreement with it, subject to guarantee of personal safety and adequate compensation. Mr Leung submitted that none of the provisions in the Termination Agreement relating to the assistance in the Company G Litigation were about consulting or contract for services. Rather, the reason why the Taxpayer was helping was the work he did when he was an employee. The daily rate was calculated based on his pay when he was an employee. Mr Leung also submitted that the payment of Sum D was agreed at the time of the Termination Agreement. Mr Leung also referred to the Taxpayer's evidence that he had not started a business of being a consultant and had not paid any tax on Sum D in any jurisdiction.

Discussion

36. This Board has been referred to the Hong Kong case law on the determination of the chargeability to Salaries Tax under section 8(1)(a) of the Ordinance of a sum paid to a taxpayer on or after the termination of employment. Both Mr Mariani and Mr Leung have drawn this Board particularly to the judgment of Ribeiro PJ (to which other members of the Court of Final Appeal agreed) in Fuchs. They also addressed this Board in some length on the Court of Appeal's judgment in Poon Cho Ming John v Commissioner of Inland Revenue [2018] HKCA 297 (1 June 2018). This Board notes that Ribeiro PJ considered the relevant English authorities in his judgment in Fuchs and that Yuen JA, giving the judgment in Poon Cho Ming John (with whom other members of the Court of Appeal agreed), underlined in paragrapg 24 that the law was what the Court of Final Appeal set out in Fuchs and the issue for determination was on the application of the law to the relevant circumstances of termination on the basis of the facts found. This Board therefore considers that it is not necessary to defer decision in this Appeal on the ground that Poon Cho Ming John is now on appeal before the Court of Final Appeal, the Court of Appeal having granted leave to appeal on 11 March 2019 ([2019] HKCA 303).

37. This Board considers that the following propositions of law, taken from Ribeiro PJ's judgment in Fuchs and from Yuen JA's judgment in Poon Cho Ming John, adequately address the questions that require determination in this Appeal, namely whether each of Sum A, Sum B1, Sum B2, Sum C and Sum D is chargeable to Salaries Tax under section 8 of the Ordinance:

(a) The question involves the construction of section 8 of the Ordinance: Whether the payment is income from any office or employment of profit. In this Appeal, the Taxpayer does not dispute that each of Sum A, Sum B1, Sum B2, Sum C and Sum D comes within the definition of 'income' in section 9 of the Ordinance. Hence the issue is whether each of the amounts constitutes income 'from' the Taxpayer's 'employment' (Fuchs paragraph 14).

(b) Not every payment which an employee receives from his employer is necessarily income 'from his employment'. It is not sufficient to qualify a payment as income 'from … employment' by simply saying that the employee would not have received the sum in question if he had not been an employee (Fuchs paragraph 15).

(c) Income chargeable to Salaries Tax under section 8(1) of the Ordinance is not confined to income earned in the course of employment but embraces payments made 'in return for acting as or being an employee', or 'as a reward for past services or as an inducement to enter into employment and provide future services'. If a payment, viewed as a matter of substance and not merely of form and without being 'blinded by some formulae which the parties may have used', is found to be derived from the taxpayer's employment in the sense mentioned above, it is assessable (Fuchs paragraph 17). The vital question is what is the 'substance of the bargain' made between the employer and the taxpayer for the payments in question. Thus even in the case of a gratuity, the payment would still be chargeable if it is a reward from the employer (e.g. for past services) – even though the employer was not obliged to pay it and thus the employee has no legal entitlement to it (Poon Cho Ming John paragraphs 25(1), 26.5).

(d) A payment that is concluded as 'for something else' is not assessable and does not come within the test stated in (c) above. Payments that fall outside the test includes damages obtained in a suit for wrongful dismissal or a payment under a settlement agreement reached in such a suit (since such a sum derives from a cause of action arising after the contract has been discharged by breach) and an indemnity paid to an employee who had purchase a house under a housing scheme set up by the employer but who had then had to sell it at a loss when directed by the employer to work elsewhere in the country (Fuchs paragraphs 18, 19). They also include a payment made to relieve the employee's distress or to help with his home purchase (Fuchs paragraph 16(c) and Poon Cho Ming John paragraph 25(3)).

(e) In so far as it is contended that a payment was not made in return for a taxpayer acting as or being an employee but as consideration for abrogating his rights under the contract of employment, the operative

test must always be the test identified in (c), reflecting the statutory language: In the light of the terms on which the taxpayer was employed and the circumstances of the termination, is the sum in substance 'income from employment'? Was it paid in return for his acting as or being an employee? Was it an entitlement earned as a result of past services or an entitlement accorded to him as an inducement to enter into the employment? If the answer is 'Yes', the sum is taxable and it matters not that it might linguistically be acceptable also to refer to it as 'compensation for loss of office' or something similar. On the other hand, the amount is not taxable if on a proper analysis the answer is 'No'. As the 'abrogation' examples referred to above show, such a conclusion may be reached where the payment is not made pursuant to any entitlement under the employment contract but is made in consideration of the employee agreeing to surrender or forgo his pre-existing contractual rights (Fuchs paragraphs 21-22 and Poon Cho Ming John paragraph 27.1). However, 'abrogation' examples are only examples and 'abrogation of contractual rights' is not itself the test of chargeability in every termination situation. The test is not whether the employer had acted in breach in terminating the contract. In every case, the test remains that of the purpose of the payment at the relevant time (Poon Cho Ming John paragraph 27.2).

(f) In the context of payments made when a contract of employment is terminated, the same consideration applies: What was the substance of the bargain between the employer and the taxpayer for the payments in question? Or what was 'the purpose of the payment': Was it a reward for services past, present or future (in which case it was 'from his employment or office'), or was it for some other reason (in which case it was not)? (Poon Cho Ming John paragraphs 20.2, 25(4)). If the employee was entitled to the payment under the contract of employment, then the purpose of the payment was in order for the employer to perform its obligations under the contract, and it follows that the payment was income 'from' the employment. But if the employee was not so entitled, then one must consider the purpose for which the employer made that payment (Poon Cho Ming John paragraph 27.2).

38. This Board has taken time to consider the evidence properly before it, and the extensive submissions made in respect of such evidence, the law and its proper application to the circumstances of the Taxpayer's case.

39. This Board, like the Taxpayer and the Revenue had done in submission, shall address and then determine whether -

(a) the sums derived from the restricted shares, being Sum A, Sum B1, Sum B2 and Sum C; and

(b) the payment for the Taxpayer's post-employment services in respect of the Company G litigation, being Sum D.

are chargeable to Salaries Tax by reason of being 'income from any office or employment of profit' under sections 8 and 9 of the Ordinance.

Sum A and Sum B1

40. This Board first considers Sum A and Sum B1, which were derived from the 2011 Shares.

41. This Board finds that the 2011 Shares were unequivocally guaranteed in the Employment Contract under the heading of 'Guaranteed Bonus'. In this connection, it is necessary to add to the Agreed Fact in paragraph 8(1) above by referring to the relevant provisions under this heading:

> 'With respect to performance year 2010, you will be guaranteed a bonus of HK$11,700,000 … This guaranteed bonus is subject to standard 2010 Global Banking and Markets deferral rates at the time of payment and it may be delivered in cash and/or deferred in the form of shares/cash, under the [Company D] Restricted Share Plan, at the sole discretion of the Company. Cash bonuses will be payable by March 2011.
>
> ……
>
> The Guaranteed Bonus in the form of restricted shares detailed above will be released on the condition you have not resigned or been dismissed as a result of your gross misconduct on the date the restricted shares are due to be released. No shares will be released to you if you are under notice of termination of employment either given to [the Company's group] or received from [the Company's group] as a result of your gross misconduct, or have been disciplined under the Company's Disciplinary Procedures, or have been lawfully dismissed for gross misconduct or with cause the time the restricted shares are due to be released.' (underlining supplied).
>
> This Board refers to the Taxpayer's testimony that the guaranteed bonus was a significant part of his compensation package. This must be the case when comparison is made with the annual base salary of HK$3,120,000 provided for under the Employment Contract.

42. This Board also notes that the continued vesting of the 2011 Shares was not subject to any condition under the Termination Agreement.

43. This Board further notes that the Taxpayer wrote to the Company on 28 January 2013 contending that he was entitled to the continued vesting of all restricted shares as part of his guaranteed bonus for performance year 2010, relying on the clause of the

Employment Contract quoted in paragraph 41 above. TDW also relied on the same clause to contend that the Taxpayer was entitled to those restricted shares under the terms of the Employment Contract.

44. This Board therefore finds that Sun A and Sum B1 were contractual entitlements the Taxpayer had under the Employment Contract.

45. Accordingly, the Taxpayer's submission that he had no accrued right to the 2011 Shares under the Employment Contract is rejected. By extension, the Taxpayer's submission that the Company's exercise of discretion to vest the 2011 Shares was consideration given for a separate bargain, namely the Termination Agreement, is also rejected. This Board finds that the vesting of the 2011 Shares was in satisfaction of the rights accrued to the Taxpayer under the Employment Contract.

46. This Board also rejects the Taxpayer's submission that the Termination Agreement was a fresh bargain between the Taxpayer and the Company under which the Company and its group was to exercise its discretion to progress the vesting of the 2010 Shares that were as of the date of the Taxpayer's termination of employment unvested and that was the primary cause for the Taxpayer being paid Sum A and B1; and that without the Termination Agreement for the progressing of the vesting schedule, the 2010 Shares that remained unvested as at the date of the termination of the Taxpayer's employment would in effect simply have lapsed. This is because:

(a) Under the Plan applicable to the 2010 Shares (namely the Group F Share Plan), the Taxpayer would be treated as a 'good leaver' as his employment was terminated on the ground of redundancy; see rule 9.2.2 thereof.

(b) As such, the portion of the 2010 Shares that were unvested at the time of the termination of employment would under rule 9.3.2 of the Group F Share Plan 'Vest on a Time-Apportioned basis (unless the Committee determines it fair and reasonable that a greater proportion shall Vest) at the time they would normally Vest in accordance with these Rules, and subject to the satisfaction of any applicable Non-Corporate Performance Condition(s) in the normal way (unless amended, relaxed or waived in accordance with rule 5.4), and shall not Vest early unless and to the extent determined by the Committee'.

(c) It should be noted that rule 9.4 of the Group F Share Plan, which required awards not to become capable of vesting until the participant in the plan 'has complied with, or is released from his obligations under, [a] Termination Agreement', did not apply in the Taxpayer's case since rule 9.4 applies only to a participant who is a 'good leaver' by reason of rule 9.2.4 ('for any other reason which the Committee considers justifies his treatment as a Good Leaver'). Hence it cannot be contended in the Taxpayer's case that the Group F Share Plan

operated in his case in a way that the unvested restricted shares would lapse but for the intervention of a termination agreement.

(d) Although rule 2.8.1 of the Group F Share Plan appeared to allow the 'Committee' to impose additional conditions to an award before vesting, none of the situations stated in rule 2.8.2 as the appropriate situations for the 'Committee' to exercise the power in rule 2.8.1 applied in the Taxpayer's case. In fact, as stated above, the continued vesting of the 2011 Shares was not subject to any condition under the Termination Agreement. Indeed the Termination Agreement stated in clause 1.1(d) that: 'For the avoidance of doubt, the 2011 Shares will continue to vest on the release date(s) set out in the letter awarding them to [the Taxpayer].'

47. This Board accordingly finds Sum A and Sum B1 are 'income from employment' within the meaning of section 8 of the Ordinance for they are amounts to which the Taxpayer was contractually entitled. Sum A and Sum B1 are chargeable to Salaries Tax.

Sum B2 and Sum C

48. Sum B2 and Sum C were derived from the 2012 Shares. The Employment Contract enabled the award of the 2012 Shares as part of a discretionary bonus but provided no guarantee of them or of their value to the Taxpayer.

49. The Termination Agreement provides under clause 1.1(b) that: 'Any release of the 2012 Shares will be conditional on [the Taxpayer] having not committed a breach of any terms of this letter, including but not limited to his not having commenced any proceedings in breach of [this clause].'

50. This Board finds that Sum B2 and Sum C, instead of being contractual entitlements under the Employment Contract, represented the value of shares that the Company released to the Taxpayer pursuant to the Termination Agreement.

51. The mere fact that the release of the 2012 Shares was made pursuant to a termination agreement is not determinative as to whether their value paid to the Taxpayer was 'income from employment'. As Yuen JA stated in Poon Cho Ming John at paragraph 27.2, 'if the employee was not [entitled to the payment under the contract of employment], then one must consider the purpose for which the employer made that payment'.

52. The Taxpayer's case was that the 2012 Shares were released for the purpose of settling potential litigation, the negotiation between TDW on his behalf and MBJ on behalf of the Company and its group over which produced the Termination Agreement.

53. To ascertain the purpose for which the Company released the 2012 Shares, one needs to consider the background against which the Termination Agreement was

entered into, as evidenced by the correspondence between the Taxpayer/TDW and the Company/MBJ. Upon reading the said correspondence, this Board observes that:

(a) In the letter dated 28 January 2013 rejecting the Company's offer of arrangements in relation to the termination of employment, the Taxpayer challenged the legal basis of the Company of imposing conditions on the vesting of the restricted shares since he considered this to be 'inconsistent with the terms of my Employment Contract and the two [Group F] Share Plans'. This was followed by the Taxpayer's consideration that he qualified as a 'good leaver' under the Plans, 'irrespective of whether I agree to sign a termination agreement with [the Company] and am entitled to continued vesting of all unvested restricted shares awards.' He also referred to his entitlement to continued vesting of the restricted shares awarded to him as part of his Guaranteed Bonus pursuant to the relevant provisions in the Employment Contract.

(b) In the correspondence that followed, the Taxpayer maintained the same position that he was contractually entitled to the continued vesting of the restricted shares. The Company disagreed. This had been the principal part of the disagreement between the Taxpayer and the Company until they reached settlement.

(c) The correspondence between the parties did not indicate an apparent prospect of litigation. Although the Taxpayer had emphasized in evidence his instructions to TDW to pursue his rights and interests under the 'carry plan', the prospects of this aspect of the dispute turning into viable litigation is very slim in light of the fact that the Employment Contract only stated the Taxpayer's eligibility to participate in a 'carry plan' and the Company's intention to discuss with him on such a 'carry plan'. The suggestion that the Taxpayer had a contingent right or interest relating to a 'carry plan' is not sustainable. While the Taxpayer had also referred to the Company's required restriction on him in engaging in business with Company M and Company N, that matter had not substantively progressed towards litigation, apart from a particular concern expressed on the part of the Taxpayer about false or defamatory statements being made about him to any third parties, which in substance was a separate matter. Regarding the Company G litigation, the Taxpayer had expressed his willingness to continue to provide reasonable assistance to the Company and its group subject to reasonable compensation and confirmation of legal and personal safety support and therefore no prospects of litigation could possibly arise. Overall, the disagreement between the Taxpayer and the Company had not gone to the point that litigation was imminent or where the Company was eager to settle to avoid litigation.

(d) The suggestion that the lodging of the DAR and the requirement of its withdrawal could be or form part of a fresh bargain is not accepted. Lodging a data access request is consistent with both negotiation and litigation. It is a matter of tactical and peripheral importance.

(e) Neither the confidentiality provision (with its extension to 'all matters' including the negotiations that led to the Termination Agreement and its particular definition of 'confidential information') nor the withdrawal of threat of litigation in light of the Termination Agreement's operating in full and final settlement of any claims constitute a fresh bargain separately or together. These two provisions were included to simply operate to conclude the negotiations.

54. In light of the observations above, this Board considers that the Taxpayer's Appeal is not a case where the progressing of the vesting of the awarded restricted shares was 'consideration to make the Taxpayer go away quietly' (the expression used in Poon Cho Ming John, paragraph 29.1). In Poon Cho Ming John, the acceleration of the vesting of the share options was aimed at avoiding any litigation from Mr Poon, and it was expressly stated by the employer company that the number of share options was 'an entirely arbitrary number', with '[no] specific basis … adopted in determining such number', and that the acceleration of vesting was done 'with a view to settling all outstanding matters upon the cessation of [Mr Poon's] employment'.

55. Rather, in the Taxpayer's Appeal, reference was made to the Taxpayer's performance, which was also the basis for granting the 2012 Shares. The Company responded to the enquiry of the Assessor of the Revenue of the basis of calculating the restricted shares in the years of performance of 2011 and 2012 in its letter dated 14 September 2017 that: '(e) the number of shares award of 72,023 and 61,323 granted to [the Taxpayer] was determined at the sole discretion of [the Company] taking into consideration a number of factors including [the Taxpayer's] performance and the performance of [the Group].' (underlining supplied).

56. This Board finds it obvious from the above that the facts of Poon Cho Ming John are quite different from those of the Taxpayer's Appeal. Poon Cho Ming John is clearly distinguishable.

57. This Board holds that the continuing release of the 2012 Shares pursuant to the Termination Agreement was not 'for something else'. Rather, this Board finds that the continuing release of the 2012 Shares to the Taxpayer was 'in return for acting or being an employee' or as a 'reward for past services'.

58. This Board accordingly finds Sum B2 and Sum C are also 'income from employment' within the meaning of section 8 of the Ordinance and are also chargeable to Salaries Tax.

Sum D

59. This Board has examined the evidence relating to the Taxpayer's rendering of assistance in the Company G litigation. This Board agreed with the Revenue's submission that the Taxpayer's contention that he was acting as an 'expert witness' or an 'independent consultant' is not borne out by any evidence. On the contrary, having considered Sum D in substance (as Fuchs paragraph 17 requires), this Board finds that both the Taxpayer and the Company had an understanding that he was assisting in the capacity of a former employee. This finding is borne out by the following evidence:

(a) The Taxpayer wrote in his letter dated 28 January 2013 that: 'Out of good faith, [he is] currently continuing to assist with the [Company G] matter. And, subject to fair terms, [he is] willing to continue doing so. [He is] prepared to provide reasonable assistance, including providing testimony via written statement, traveling to [Country J] once for each claim …, being reasonably available in Hong Kong to assist, participating via teleconference or video conference where reasonably requested, in each case subject to any other professional obligation [he has] at the time, as well as safety and family considerations.'

(b) Clause 2.1(a) and (b) of the Termination Agreement, which came under the heading of 'Obligations after termination of employment', stated that the Taxpayer would provide 'reasonable assistance in relation to any claim or threatened claim, investigation, administrative or regulatory proceeding as the Company or the Group may reasonably require in relation to any matter with which [the Taxpayer] was dealing during his employment and/or any matter which arises after the termination of [the Taxpayer's] employment with the Company but in relation to which [the Taxpayer] has relevant knowledge.'

(c) MBJ explained in their letter dated 3 May 2013 to TDW that the compensation rate of HK$12,692 was calculated on the basis of 1/260 per day of the Taxpayer's final fixed pay.

60. It is well-established that a payment would be taxable in so far as it is '*made in reference to the services the employee renders by virtue of his office, and it must be something in the nature of a reward for services past, present or future*': Hochstrasser (Inspector of Taxes) v Mayes [1960] AC 376 (HL) at 388. Hence the fact that assistance was rendered by the Taxpayer after termination of employment does not preclude this Board from holding against the Taxpayer's contentions regarding Sum D.

61. This Board accordingly finds Sum D is 'income from employment' within the meaning of section 8 of the Ordinance and is chargeable to Salaries Tax.

Decision

62. This Board holds that the Taxpayer has failed to discharge the burden of proof he has under section 68(4) of the Inland Revenue Ordinance to show that the Additional Salaries Tax Assessments for the year of assessment 2012/13 he has challenged were excessive or incorrect. The Taxpayer's appeal has to be dismissed. The Additional Salaries Tax Assessment for the year of assessment 2012/13, dated 18 March 2014, showing additional net income of HK$2,214,468 with additional tax payable thereon of HK$332,170, is affirmed. The Additional Salaries Tax Assessment for the year of assessment 2012/13, dated 22 January 2015, showing additional net income of HK$5,551,288 with additional tax payable thereon of HK$832,693, is affirmed.

63. This Board makes no order as to costs.