

Case No. D18/20

Salaries tax – payment in lieu of termination notice – notice period covering two financial years – whether payment fully assessed in the first financial year – sections 2(1), 8(1), 9(1), 11B, 11C, 11D and 68(4) of the Inland Revenue Ordinance (‘IRO’)

Panel: Wong Kwai Huen (chairman), Lee Wong Wai Ling and Yuen Hoi Ying.

Date of hearing: 20 November 2020.

Date of decision: 18 February 2021.

The appellant was employed by B and the employment could be terminated by 6 months’ notice. In 2018, B informed the appellant that it would terminate the latter’s employment with effect from 24 November 2018, giving the appellant 6 months’ payment in lieu of notice in the sum of \$398,760 (‘Sum’). The Commissioner raised Salaries Tax Assessment for the year 2018/19 on the appellant, who objected to the assessment, claiming that part of the Sum was income relating to the period from 1 April 2019 to 23 May 2019 and should be assessed in the year 2019/20. The Commissioner confirmed the assessment despite the objection.

In the appeal before the Board, the appellant contended that: (a) upon termination, he signed a Non-Disclosure Agreement (‘NDA’) with B which provided that he should not be engaged with B’s staff for a period of no more than 6 months; (b) the appellant received an offer in January 2019 but had to turn it down because of the NDA and the fact that he had received the Sum from B; (c) payment of the Sum precluded him from being employed in a similar capacity until 23 May 2019; (d) he had received similar payments upon termination on two previous occasions, neither of them were chargeable to any tax; and (e) he would have to pay more tax if the Sum was assessed fully in 2018/19.

Held:

1. The appellant’s last employment date was 23 November 2018. By the operation of section 11C and proviso (ii) to section 11D, the appellant was deemed to cease to derive income from B effective from 24 November 2018 and the Sum was deemed to have accrued to the appellant on 23 November 2018. It followed that the Sum should be included as the appellant’s assessable income for the year 2018/19 (D28/95, IRBRD, vol 10, 169, D42/06, (2006-07) IRBRD, vol 21, 794 and D1/10, (2010-11) IRBRD, vol 25, 144 considered).
2. Regarding the appellant’s contentions on appeal, (a) there was insufficient evidence to support the allegation that he turned down an offer because of

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the NDA and receipt of the Sum, and all evidence pointed towards the Sum being a payment in lieu of notice chargeable to salaries tax; (b) there was no evidence to support the allegation of his previous tax treatments, which in any event had no bearing in this appeal; (c) sections 11C and 11D were deeming provisions and could work against or in favour of a taxpayer depending on the circumstances. In this case, even though the tax treatment might not favour the appellant, it would not exonerate him from his tax liability (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 and D42/06, (2006-07) IRBRD, vol 21, 794 considered).

Appeal dismissed and costs order in the amount of \$15,000 imposed.

Cases referred to:

D28/95, IRBRD, vol 10, 169
D42/06, (2006-07) IRBRD, vol 21, 794
D1/10, (2010-11) IRBRD, vol 25, 144
EMI Group Electronics Ltd v Coldicott (H M Inspector of Taxes) [1999] STC 803
Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74

Appellant in person.

Yun Rita and Chan Wai Lin, for the Commissioner of Inland Revenue.

Decision:

1. Background

- (1) Mr A ('the Appellant') has objected to the Salaries Tax Assessment for the year of assessment 2018/19 raised on him. The Appellant claims that the assessment is excessive.
- (2) (a) By an employment contract dated 1 September 1998 ('the Employment Contract'), the Appellant was employed by Company B as Position C with effect from 22 September 1998 at a monthly salary of \$32,000. The Employment Contract provided, among other things, that after a probation period of six months, the employment was terminable by either party by giving the other party three months' prior notice. The Appellant confirmed and accepted the terms of the Employment Contract on 7 September 1998.
- (b) By a letter dated 20 March 2006, Company B informed the Appellant that he was promoted to the position of Senior Position C with effect from 1 October 2005 and his monthly

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salary was revised to \$46,000. As a senior manager grade and in view of the importance of his position within Company B, the notice of termination by either party was changed to 6 months. The Appellant signed to confirm the revised terms of his employment.

- (c) The Appellant's monthly salary was revised to \$66,460 with effect from 1 April 2018.
- (3) By a letter dated 23 November 2018, Company B informed the Appellant, among other things, the following:
- (a) Company B was undergoing a restructuring and had determined to terminate the employment with Appellant with effect from 24 November 2018.
- (b) According to the Employment Contract, Company B gave the Appellant 6 months' payment in lieu of notice to terminate his employment and his last employment day was 23 November 2018.
- (4) Company B filed a notification by an employer of an employee who was about to cease to be employed in respect of the Taxpayer for the year of assessment 2018/19, which showed, among other things, the following particulars:
- | | |
|-----------------------------|-------------------------|
| (a) Period of employment: | 01-04-2018 – 23-11-2018 |
| (b) Reason for cessation: | Redundant |
| (c) Details of income: | \$ |
| Salary | 516,172 |
| Payment in lieu of notice | 398,760 ('the Sum') |
| Leave pay and other rewards | <u>104,083</u> |
| Total | <u>1,019,015</u> |
- (5) In his Tax Return – Individuals for the year of assessment 2018/19, the Appellant declared that his salaries income from Company B for that year was \$1,329,003 including the Sum and a statutory severance payment of \$309,986 ($\$22,500 \times 2/3 \times 20.6658$ years). The Appellant stated that the Sum and the severance payment were received by him on 23 November 2018.

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- (6) Based on the information reported by Company B as well as the tax return filed by the Appellant, the Respondent raised on the Appellant the following Salaries Tax Assessment for the year of assessment 2018/19:

	\$
Income	1,019,015
<u>Add: Spouse income</u>	<u>25,253</u>
	1,044,268
<u>Less: Deductions</u>	<u>22,643</u>
Net Income	1,021,625
<u>Less: Allowances</u>	<u>559,000</u>
Net Chargeable Income	<u><u>462,625</u></u>
Tax Payable thereon	<u><u>40,646</u></u>

- (7) The Appellant objected to the assessment in paragraph (6) above claiming that he was terminated by Company B with immediate effect on 23 November 2018 and was paid the Sum which was 6 months' salaries in lieu of notice covering the period from 24 November 2018 to 23 May 2019. An amount of \$117,412 (i.e. \$66,460 + \$50,952), included in the Sum, was salaries income relating to the period from 1 April 2019 to 23 May 2019. Since it was his income for the year of assessment 2019/20, it should be assessed in the year of assessment 2019/20.
- (8) In response to the Respondent's enquiries, Company B provided, among other things, the following information and document:
- (a) The Appellant's employment was terminated by reason of redundancy.
- (b) The Sum was paid in accordance with the provisions of the Employment Ordinance which being a payment of 6 months' salaries in lieu of notice.
- (c) A copy of the statement of final payment in respect of the Appellant which showed that the Sum was paid to the Taxpayer on 23 November 2018 and was computed as:

$$\$66,460 \times 6 \text{ months} = \$398,760$$

- (9) The Respondent invited the Appellant to withdraw his objection as the Sum was his income chargeable to Salaries Tax in the year of assessment 2018/19. Even though the Sum covered the period from 24 November 2018 to 23 May 2019, it should be deemed to have been accrued to him on the last date of his employment (i.e. 23 November

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2018) and be assessed in the year of assessment 2018/19 pursuant to proviso (ii) to section 11D(b) of the Inland Revenue Ordinance ('the Ordinance').

- (10) The Appellant declined to withdraw his objection and made the following claims:
- (a) If an employee received a lump sum payment, such as bonus, after he/she had served the employer for two years and left his/her job, the lump sum payment could be related back in two years of assessment for taxation. His case was similar. Since the Sum was his salary income for the period from November 2018 to May 2019, which fell into two years of assessment, it should be apportioned and be assessed in two years of assessment.
 - (b) He doubted whether the Sum should be chargeable to Salaries Tax. He had once received one month's payment in lieu of notice in the year of assessment 1998/99 and the payment was not chargeable to Salaries Tax.

2. The Issue

The issue for the Board to decide is whether the Sum i.e. the payment in lieu of six months' notice in the amount of \$398,760 made to the Appellant by his former employer, Company B should be fully assessed in the year of assessment 2018/19 or partly in the year of assessment 2018/19 and partly in the year of assessment 2019/20.

3. Statutory Provisions

The Respondent referred the Board to the following statutory provisions in the Ordinance.

(1) Section 2(1)

“year of assessment” (課稅年度) means the period of 12 months commencing on 1 April in any year’.

(2) Section 8(1)

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

- (a) any office or employment of profit; and*

(b) ...’

(3) Section 9(1)(a)

‘(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 ...’*

(4) Section 11B

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

(5) Section 11C

‘*For the purpose of section 11B, a person shall be deemed to ... cease ... to derive income from a source whenever and as often as he ... ceases –*

(a) *to hold any office or employment of profit ...’*

(6) Section 11D

‘*For the purpose of section 11B –*

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

...

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

Provided that –

(i) ...

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

(7) **Section 68(4)**

'The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'

4. The Relevant Case Law

The Respondent referred the Board to the following authorities:

(1) In D28/95, IRBRD, vol 10, 169, the taxpayer resigned from Company A on 13 March 1991. On 9 August 1991, he reached a compromise agreement with Company A whereby Company A agreed to pay the taxpayer \$795,000 being arrears of housing allowance due to him by 17 instalments between July 1991 and October 1993. By 12 July 1994, the taxpayer had received \$795,000 in full. The taxpayer contended that this sum should be assessed as income for the years of receipt. The Board, in dismissing the taxpayer's appeal, said that:

'7.8 By section 11C, the Taxpayer is deemed to cease to derive income from Company A upon termination of his employment with Company A on 12 or 13 March 1991.

7.9 By section 11D(b)(ii), the various payments totalling \$795,000 which were made after 12 March 1991, that is, after the Taxpayer has been deemed by section 11C to cease to derive income, are deemed to have accrued to the Taxpayer on the last day of employment, that is, on 12 March 1991.

7.10 By the date of the determination, the Taxpayer had received \$795,000 in full. Section 11D(a) requires an additional assessment to be raised in respect of such income. This is what the Commissioner has in effect done ...'

(2) In D42/06, (2006-07) IRBRD, vol 21, 794, the taxpayer's employment was terminated on 16 March 2004 and he received a sum of money, being his housing allowance for the month of March 2004, on 29 June 2004. The taxpayer claimed that he had not been entitled

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to claim payment of the housing allowance in the year of assessment 2003/04. As the allowance had eventually been paid to him in the year of assessment 2004/05, it should be assessed as his income for the same year. Having considered the decisions in D28/95 and D75/04, the Board rejected the taxpayer's claims and held that the housing allowance should be assessed as his income for the year of assessment 2003/04.

- (3) In D1/10, (2010-11) IRBRD, vol 25, 144, the taxpayer received a bonus in May 2007, after the cessation of his employment on 31 March 2007. He claimed that the bonus should be included as assessable income in the year of assessment 2007/08 according to the date of receipt, but not 2006/07 as he was assessed. He also complained that it was unfair to include bonus for two years under one year of assessment. In dismissing the appeal, the Board held that the combined effect of sections 11C and 11D of the Ordinance was that any payment received by the appellant after his employment ceased was deemed to have accrued to him on the last day of his employment i.e. 31 March 2007, and the bonus was correctly assessed in the year of assessment 2006/07, notwithstanding the actual date of receipt of the bonus. The Board also commented that there was no unfair treatment to the appellant, and the treatment he received was merely a fiscal consequence arising from his change in employment status.
- (4) In EMI Group Electronics Ltd v Coldicott (HM Inspector of Taxes) [1999] STC 803, the English Court of Appeal held that a payment in lieu of notice made in pursuance of a contractual provision, agreed at the outset of the employment, which enabled the employer to terminate the employment on making that payment was properly to be regarded as an emolument from that employment. Chadwick LJ made the point that an employee's entitlement to a notice of the employer's intention to terminate his employment, or to a payment in lieu of the notice, was a security which the employee required as an inducement to enter into the contract of employment.
- (5) In the Court of Final Appeal case Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74, Ribeiro PJ held that the approach in EMI Group which concerned the taxation of payment in lieu of notice should be adopted in the construction of section 8(1) of the Ordinance, i.e. a payment in lieu of notice, contractually agreed from the outset of the employment relationship, fell squarely within it.

5. The Case of the Appellant

The Appellant's arguments can be summarized as follows:

- (a) His employment was terminated by Company B by way of payment in lieu of six months' notice. The six-month salary in lieu was meant to cover the period from November 2018 to May 2019, which was related to the years of assessment 2018/19 and 2019/20.
- (b) The six months' salary represented wages for the 6 months straddling between the years of assessment of 2018/19 and 2019/20 and should be apportioned accordingly.
- (c) Upon his termination, the Appellant signed a Non-Disclosure Agreement (NDA) with Company B and its parent company Company D which provided that the Appellant 'shall not be engaged with our staff directly or indirectly to join your company or another company for a period of no more than six months after you have left our company'.
- (d) The Appellant received an offer on 31 January 2019 from one Company E but he had to turned it down because of the NDA and the fact that he had received '6-month payment from [Company B] till 23 May 2019'.
- (e) The Appellant argued that the 6 months' payment of salary in lieu of notice precluded him from being employed in a similar capacity as his position in Company B until 23 May 2019.
- (f) The Appellant alleged that he had received payments in lieu of notice upon his termination of employment on two previous occasions in the years of assessment in 1995/96 and 1998/99. Neither of them were chargeable to any tax.
- (g) With the Respondent's assessment of the six months' salary in the year of assessment 2018/19, the Appellant had to pay approximately \$20,000 more tax.

6. Finding

- (1) This is an open and shut case and the Board has no difficulty in rejecting all the Appellant's contentions.
- (2) As clearly stated in the termination letter, the Appellant's employment with Company B was terminated with effect from 24 November 2018 by way of a payment in lieu of notice and the Appellant's last employment date was 23 November 2018.

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- (3) According to the breakdown of the final payments to the Appellant and the total income reported for his remuneration for the year of assessment 2018/19 including his basic salary, annual leave and bonus were accrued up to 23 November 2018. The contributions to provident fund by the Appellant and Company B were also accrued up to November 2018. These findings were consistent with the information contained in the Appellant's termination letter.
- (4) Based on the above facts and by the operation of section 11C of the Ordinance, the Appellant was deemed to cease to derive income from Company B effective from 24 November 2018. The Sum was made to the Appellant in return for his acting as or being an employee of Company B. By the operation of proviso (ii) to section 11D(b) of the Ordinance, the Sum was deemed to have accrued to the Appellant on 23 November 2018 i.e. the last day of his employment with Company B. It followed that the Sum should be included as the Appellant's assessable income for the year of assessment 2018/19. There was no case for the Sum to be assessed in two tax years.
- (5) The above conclusion is supported by the Board's previous decisions in D28/95, D42/06 and D1/10.
- (6) The Board found it difficult to accept the Appellant's allegation that he had to turn down an offer of employment in January 2019 because of the NDA and the Sum he had received. There was simply no sufficient evidence to support such an allegation. Firstly, the NDA appeared only to restrict the Appellant from poaching the employees of Company B and its parent company. It did not operate to restrict the Appellant from being employed even from a competitor. The Appellant also failed to produce any evidence to prove that the Sum was in any way in the nature of compensation for or consideration of his entering into the NDA. All the evidence points towards the Sum being no more no less a payment in lieu of notice and, as such, on the authority of Fuchs, it was income from employment and chargeable to Salaries Tax by virtue of sections 8(1)(a) and 9(1)(a) of the Ordinance. There are no two ways about it.
- (7) The Appellant claimed that he would have to pay more tax if the Sum was assessed in the year of assessment 2018/19. It should be noted that the tax treatment received by the Appellant in respect of the Sum was merely a fiscal consequence arising from his change in employment status. In D42/06, the Board stated that sections 11C and 11D of the Ordinance were 'all "deeming" provisions' and they could 'work against or in favour of a taxpayer depending on the personal circumstances of the individual taxpayer'. In this case, even though the subject tax treatment might not favour the Appellant, it would not

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exonerate him from his tax liability. After all, the same treatment would apply across the board to all other employees of Company B under similar circumstances.

- (8) As regards the allegations that the Appellant was not chargeable to any tax in respect of payment in lieu of notice on two occasions in the years of assessment 1995/96 and 1998/99, there was not a thread of evidence to support these allegations. It was impossible for the Respondent to make any comment in reply. The Board must reject such allegations. Suffice to say, the Board must follow the judgment of the Court of Final Appeal in the Fuchs case which was made in 2011. On this authority, a payment in lieu of notice contractually agreed from the outset of the employment relationship is income from employment chargeable to tax as from the year of assessment 2012/13 onwards. What happened to the Appellant's tax treatment in 1995/96 and 1998/99 will have no bearing in this appeal.

7. Conclusion

The Board finds that the Appellant has failed to discharge the burden proving that assessment appealed against is excessive or incorrect. The appeal is dismissed.

8. Costs

Pursuant to section 68(9) of the Ordinance, the Appellant is ordered to pay costs of the Board in the sum of HK\$15,000.