Case No. D20/17

Salaries tax – termination of employment – termination payment – sections 8(1), 9(1)(a), 11B, 11D, 12(1), 68(4), and 68(9) of the Inland Revenue Ordinance

Panel: Chui Pak Ming Norman (chairman), Julien Chaisse and Claire Wilson.

Date of hearing: 4 September 2017.
Date of decision: 19 December 2017.

By a letter dated 16 June 2011, Company A terminated the employment with the Appellant with immediate effect.

For the year of assessment 2011/12, Company A filed notifications in respect of the additional payments of $2,715,790 (the 'First Sum') made to the Appellant after the Appellant had left the employment.

According to the notifications filed, the Assessor raised on the Appellant the 2011/12 additional Salaries Tax Assessment which was later revised downwards by an apportionment of Payment in lieu of Notice.

The Appellant objected to the revised additional Salaries Tax Assessment contending that the First Sum was paid to him by way of compromise and abrogation of his claims in court proceedings against Company A.

Held:

1. The First Sum (which was deemed to have accrued on the last day of his employment, i.e. 16 June 2011), was paid to the Appellant in relation to the past services he provided to Company A as an employee.

2. There were no evidence to substantiate the other claims which the Appellant made against Company A. The Board sees no reason and logic why such other claims should be deductible from the First Sum for assessment of Salaries Tax liability.

3. Whether or not the Appellant recovered the same by way of settlement with Company A, the legal costs incurred by him were not incurred in the performance of his employment duties and is therefore not deductible.

4. The First Sum was not a payment related to non-compete post-termination restrictive covenants.

Appeal dismissed and costs order in the amount of $10,000 imposed.

Cases referred to:

D76/98, IRBRD, vol 13, 420
D30/11, (2011-12) IRBRD, vol 26, 524
D33/13, (2014-15) IRBRD, vol 29, 84
Commissioner of Inland Revenue v Humphrey 1 HKTC 451
Commissioner of Inland Revenue v Robert P Burns 1 HKTC 1181
Commissioner of Inland Revenue v Elliott [2007] 1 HKLRD 297
Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74
Brown v Bullock 40 TC 1
Humbles v Brooks 40 TC 500
Lunney v Commissioner of Taxation (1957) 100 CLR 478

The Appellant in person.
Chow Cheong Po and Ng Ching Man, for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal brought by the Appellant against the determination of the Deputy Commissioner of Inland Revenue dated 22 September 2016 ('Determination') whereby the additional Salaries Tax Assessment of $2,715,790 for the year of 2011/12 raised on the Appellant, save for a downward revision of $443,460, with Additional tax payable thereon of $340,849 is confirmed.

2. The Appellant lodged a Statement of the Grounds of Appeal (incorporating the Notice of Appeal) dated 10 October 2016 against the Determination with the Board on 10 October 2016.

3. There were 3 broad grounds of the appeal raised by the Appellant in the Notice of Appeal, which were summarized as follows:

(a) The Deputy Commissioner erred in law in failing to conclude that, upon true construction of the SA[1] and PSA[2] and the Employment Agreements, the Sum[3], representing the Appellant's entitlement in

[1] Means the Settlement Agreement dated 2 May 2013 and entered into amongst the Appellant and Company A

[2] Means the Partnership Separation Agreement dated 2 May 2013 and entered into between the Appellant and Company B

[3] The amount of US$350,000 referred to in Clause 2.2(b) of the SA

respect of his GUA[4], except for the shortfall in PILON[5] and other claims, was compensation for the abrogation of the Appellant's Partnership rights in respect of those GUA and therefore not chargeable to tax.

(b) The payment as set out in part 2.2(b) of the Settlement Agreement (i.e. 'the First Sum') included not only the settlement of the Grant Unit Awards, but also the settlement of a number of other claims which the Appellant was making against his former employees Company A/Company B including but not limited to:

(i) Loss of refund of US Taxes;

(ii) Shortfall in PILON amounting to HK$693,186.36 and this 'whole' sum, and not just an apportionment as suggested by the Deputy Commissioner, must be deductible since this is a mandatory termination payment and as discussed and impliedly agreed by the parties during the SA & PSA negotiations;

(iii) Interest Losses and Loss of Opportunity regarding the voluntary investment of US$350,000 and Company B Partnership dated 17 April 2010;

(iv) Loss of quarterly dividend payments and interests on the missing 2nd Commission 2010; and

(v) Additional claims related to Interests, Costs and further or other relief as set out in paragraphs (VI), (VII), (VIII) and (IX) of the Statement of Claim filed with the High Court.

Furthermore, the Legal Fees amounting to US$188,500 (equivalent to HK$1,462,647) should be deductible under section 12(1) of the Inland Revenue Ordinance ('Ordinance').

(c) Given the terms of the Grant Unit Awards, they may have been an inducement for the Appellant not to take up employment with a competitor for a period of four years and thus, preventing the Appellant to earn a living. Furthermore, paragraph 4(g) of the PSA introduced a post-termination non-poaching restrictive covenant for a period of 24 months from the effective date, 2 May 2013. Consequently, payment related to non-compete post-termination restrictive covenants is not employment income (i.e. 'in return for acting as or being an employee' or ….. 'as reward for past services or

[4] Grant Unit Awards
[5] Payment in lieu of Notice

as an inducement to enter into employment and provide future services') and therefore should be declared non-taxable.

4. The Statement of Grounds of Appeal dated 10 October 2016 was to elaborate further the grounds of appeal.

5. The Appellant agreed to paragraphs (1) to (16) and (18) to (19) of the Determination. Accordingly we find paragraphs (1) to (16), and paragraphs (18) to (19) of the Determination as relevant facts of this appeal, which are set out in paragraphs 7 to 22 and paragraphs 24 to 25 below respectively. Regarding paragraph (17) and paragraph (20) of the Determination, we also set out those parts not in dispute as facts of this appeal respectively in paragraph 23 and paragraph 26 hereof.

6. Neither party called any witness to testify nor any one of them submitted further documents evidence for the Board's consideration. They relied on the documents in the bundles of documents submitted. None of them disputed the authenticity of the documents so submitted.

Facts of the Appeal

7. The Appellant has objected to the additional Salaries Tax Assessment for the year of assessment 2011/12 raised on him. The Appellant claims that certain sum received from his ex-employer should not be chargeable to tax.

8. Company A was incorporated as a private company in Hong Kong on 28 July 2000. The ultimate holding company of Company A was Company B, a limited partnership in the United States of America.

9. By a Broker Commission Contract dated 19 May 2004 ('the 2004 Contract'), the Appellant was employed by Company A as Position C on the Equity Options Desk. The 2004 Contract contains, *inter alia*, the following terms and conditions:

(a) Commission Compensation (Clause 3)

(i) '(a) [The Appellant] will be paid a guaranteed fixed draw of HK$150,000 per month. After 1 year form the Commencement Date if 35% of the commission revenue [the Appellant has] generated in any consecutive 6 month period ("the Relevant Period") is less than [his] fixed draw in the Relevant Period, [the Appellant] agree that [Company A] has the right to reduce [his] draw to a level commensurate with one third of the average monthly commission revenue [the Appellant] generated in the Relevant Period.'

(ii) '(b)(i) [Company A] may, in its absolute discretion, pay [the Appellant] a bonus. Determination of the payment and amount (if any) of any such discretionary bonus will, after consultation with the Executive Managing Director responsible for the Desk, be made by the President and Chief Executive Officer of [Company A] and final determination shall be made at the sole and absolute discretion of the President of [Company B]. Notwithstanding any other provision of this Agreement, [Company A] may require [the Appellant] to take a Grant Award in [Company B] representing up to 10% of the total annual compensation payable to [him] herein in lieu of cash from [Company A] and the timing of such Grant Award shall be at the discretion of [Company A] and [Company B].'

(iii) '(b)(iii) Any discretionary bonus made to [the Appellant] under this clause 3(b) will be paid semi-annually and in accordance with the then [Company A] policy (which policy may change from time to time at the sole discretion of [Company A]), provided always that [the Appellant] remain employed by [Company A] and [is] attending the workplace and [has] not given notice or attempted to procure [his] release from [his] contract of employment nor [has] given notice to [Company A] pursuant to clause 9.8 of the attached Terms and Conditions on the date such bonus is payable, failing which [the Appellant] shall have no entitlement to any bonus payment whatsoever.'

(b) <u>Termination</u> (Clause 5)

'The minimum period of notice which shall be given by [Company A] to [the Appellant] or by [the Appellant] to [Company A] to terminate [his] employment shall be 6 months.'

10. By an agreement dated 2 December 2009 ('the 2009 Contract'), Company A confirmed that the Appellant would be employed as Position D on the Equity Derivatives desk. The 2009 Contract contains, inter alia, the following terms and conditions:

(a) <u>Commencement and Duration</u> (Clause 2)

'2.4 This Agreement is in substitution of any previous contract of employment with [Company A] or any Associated Company. [The Appellant's] continuous employment with [Company A] began on 1 July 2004.'

(b) Remuneration (Clause 5)

(i) '5.1 With effect from 1 October 2009, [the Appellant's] fixed draw will be HKD200,000 per month subject to tax and statutory deductions ("Fixed Draw"). The Fixed Draw shall be paid monthly in accordance with [Company A's] then accounting policies and practices, as applicable from time to time.'

(ii) '5.2 During employment [the Appellant] will be required to generate a certain level of commission revenue commensurate to [his] level of responsibilities and Fixed Draw and if 35% of the commission revenue generated by [the Appellant] in any consecutive six (6) month period is less than [his] Fixed Draw over the same six (6) month period, [Company A] reserves the right to reduce [his] Fixed Draw so that it is equal to one third of the average monthly commission revenue generated by [the Appellant] in that six (6) month period.'

(iii) '5.3 [The Appellant] will be paid commission (if any) in accordance with the terms of the attached schedule.'

(iv) '5.4 In addition, [Company A] may, in its absolute discretion, award [the Appellant] a discretionary bonus in accordance with the terms of the attached schedule.'

(c) Commission Payment and Discretionary Bonus (Schedule)

(i) '[The Appellant] shall be paid commission (the "Commission Payment") which shall be equal to:

50% of Net Revenue

LESS

Expenses (as such terms are defined below).'

(ii) 'Any Commission Payment or discretionary bonus made to [the Appellant] will be awarded semi-annually, 90 days in arrears in accordance with [Company A] policy (which policy may change from time to time at the absolute discretion of [Company A].)'

(iii) 'Notwithstanding any other provision of this Agreement, a portion of any Commission Payment, bonus or other

remuneration payable (after Fixed Draw) (and subject to a cap of 10% of [his] total remuneration) may, as determined in the sole and absolute discretion of [Company A], consist of (rather than cash) a contingent non-cash grant, subject to the terms of the grant document(s) under which such non-cash was awarded, including any vesting and cancellation provisions and restrictive covenants contained therein.'

(d) Notice of Termination (Clause 8)

'[The Appellant's] employment with [Company A] may be terminated at any time by either party giving not less than six (6) months' notice in writing. This period may be reduced to three (3) months' notice in writing if this is agreed and approved by both parties in writing.'

11. In connection with the Appellant's employment with Company A, Company A had caused Company B to award to the Appellant various grants which consisted of grant units in Company B ('Grant Units') and amounts in Grant Tax Payment Account (collectively 'Grant Awards'). The Appellant and Company B had entered into various Incentive Unit Bonus Plan Award Agreements ('the Award Agreements'). Apart from that, Company B has issued an Incentive Bonus Plan Award Notification ('the Award Notification') to the Appellant. The Award Agreements and the Award Notification showed the following particulars:

Date of award	Total Award	Grant Units awarded		Grant Tax Payment Account
		No. of units	Reinvestment price per unit	
Award Agreement	US$		US$	US$
31-12-2005	40,000	421	47.5	20,000
01-09-2006	40,000	421	47.5	20,000
01-04-2007	30,000	411	47.5	10,500
Unknown	50,000*	542	60.0	17,500
01-04-2008	86,000	799	70.0	30,100
01-09-2008	70,000	650	70.0	24,500
Award Notification				
12-10-2010	28,940	241	60.0	14,470

* It was handwritten thereon the correct amount of total award should be US$65,000.

12. The Award Agreements contained, *inter alia*, the following terms:

(a) 'All Awards granted are under and pursuant to the Incentive Unit Bonus Plan (the "Plan") and are subject to all of the terms and

conditions of this Award Agreement, the Plan, and the Partnership Agreement.'

(b) 'Notwithstanding the terms of the Partnership Agreement, [the Appellant] shall not be entitled to any allocations of Income or distribution in respect of Grant Units awarded hereunder, as of any date during the employment of [the Appellant] by an Affiliated Entity upon which [the Appellant], in the reasonable judgment of the Managing General Partner, (i) shall have ceased to perform substantial services as an employee of any of the Affiliated Entities of the Partnership or (ii) shall have directly or indirectly entered into any arrangement, understanding or agreement, whether oral or written, to participate, engage, render services to or become interested in (as owner, stockholder, partner, lender or other investor, director, officer, employee, consultant or otherwise) any business activity that is in competition with, or otherwise related to or arises from, the ten current or contemplated business of any Affiliated Entity.'

(c) 'The Grant Units issued hereunder as well as any Grant Units hereafter acquired by [the Appellant] upon reinvestment of [the Appellant's] earnings on the Grant Units shall have no voting rights.'

13. Agreement of Limited Partnership of Company B (amended and restated as of 12 May 2008) contains, *inter alia*, the following terms:

(a) <u>Transfer restrictions</u>

Each partner agrees not to transfer any of his, her or its Units other than by sale to the Partnership upon the terms and conditions stated in this Agreement, unless such Partner shall have received the written consent of the Managing General Partner, which consent may be withheld for any reason in the sole and absolute discretion of the Managing General Partner.

(b) <u>Termination</u>

'Termination', including the form 'Terminated' shall mean, with respect to any employee unitholder, the actual termination of employment of a Partner, such that such Partner is no longer an employee of the Partnership or any affiliated entities for any reason whatsoever.

(c) <u>Post-Termination Payments to Grant Unitholders</u>

(i) Following the termination of a Grant Unitholder, the Partnership shall pay to such Grant Unitholder an amount ('the Post-Termination Payment') equal to (a) the number of Grant

Units issued to such Unitholder by grant from the Partnership (but not any Grant Units issued as a result of reinvestment with respect to Grant Units) times (b) the reinvestment price for such Grant Units on the date of issuance.

(ii) The Post-Termination Payment shall be paid in four equal instalments on each of the first, second, third and fourth anniversaries of the termination of the Partner provided that such Partner has not engaged in any competitive activity prior to the date such payments are due.

(d) Grant Tax Payment Accounts

(i) Creation of Grant Tax Payment Accounts: in connection with the issuance of Grant Units, the Partnership may, at the election of the Managing General Partner, establish for a holder of any Grant Unit an account ('the Grant Tax Payment Account') in an amount established by the Managing General Partner. No interest or other earnings shall be credited to any Grant Tax Payment Account.

(ii) Payment of Grant Tax Payment Accounts: if a Partner for whom a Grant Tax Payment Account has been established shall become a Terminated Partner, such Partner shall be entitled to be paid the amount of such Partner's Grant Tax Payment Account in four equal annual instalments within 90 days of each of the first, second, third and fourth anniversaries of the date such Partner becomes a Terminated Partner, provided that such Partner has not engaged in any competitive activity prior to the date any such payment is due.

14. By a letter dated 16 June 2011, the Appellant was informed that his employment with Company A would be terminated with immediate effect. Upon termination of his employment, the Appellant would be paid the following:

	$
Basic salary (16 days from 1 June 2011 to 16 June 2011)	105,206
Unused annual leave (36 days)	236,713
Payment in lieu of notice (6 months)	1,200,000
Long Service Payment (7.46 years)	111,900
	1,653,819

15. In his Tax Return – Individuals for the year of assessment 2011/12, the Appellant declared the following income:

Name of employer	Capacity	Period	Amount
			$
Company A	Position D	01-04-2011-16-06-2011	741,919
Company E	Position F	06-10-2011-11-11-2011	246,916
Company G	Position H	01-12-2011-31-03-2011	1,883,200
			2,872,035

16. The Assessor raised on the Appellant the following 2011/12 Salaries Tax Assessment:

	$
Income	2,872,035
Less: Retirement scheme contributions	12,000
Net Income	2,860,035
Tax Payable thereon at standard rate	417,005

The Appellant did not object to the assessment which became final and conclusive under section 70 of the Ordinance.

17. On diver dates, Company A filed notifications in respect of the Appellant for the year of assessment 2011/12, which showed, inter alia, the following particulars:

Nature of notification	:	Original	Additional
Period of employment		01-04-2011 to 16-06-2011	
Capacity in which employed	:	Position D	
Reason for cessation	:	End of employment	
Particulars of Income	:	$	$
Salary		505,206	-
Leave Pay		236,713	-
Payments made after the employee has left the employment		-	2,715,790
		741,919	2,715,790

18. In accordance with Company A's additional notification, the Assessor raised on the Appellant the following 2011/12 additional Salaries Tax Assessment:

	$
Additional income	2,715,790
Additional Tax Payable thereon	407,368

19. The Appellant objected to the above additional Salaries Tax Assessment on the ground that the sum of $2,715,790 ('the Second Sum') was paid to him by way of compromise and abrogation of his claims in court proceedings against Company A and hence should not be regarded as income from employment.

20. The Appellant provided the following information and documents:

(a) On 4 November 2011, the Appellant wrote to the Managing General partner of Company B requesting

 (i) repayment of funds in the amount of US$350,000 remitted by him to Company B in 2010 with the intention of investing in Company B; and

 (ii) Post-Termination Payments with respect to vested Grant Units and his Grant Tax Payment Account awarded as a portion of his employment bonus.

(b) On 8 March 2012, the Appellant filed a claim with the Labour Tribunal against Company A. In the Statement of Claim, the Appellant stated the following particulars:

Commission in Grant Units under the 2004 Contract

 (i) During the period from July 2005 to June 2009, the Appellant was awarded a 'discretionary bonus' for each six month period from January to June and July to December. Despite the payment was described in the 2004 Contract as 'discretionary bonus', as initially agreed and in practice the payments were contractual, it was a commission payment. In addition to the 'bonuses' paid to him in cash, the Appellant was notified that he had been 'awarded' the following Grant Units, which represented 10% of his total annual compensation:

Commission period	Amount of compensation 'paid' in Grant Units (USD)
Jul – Dec 2005	40,000
Jan – Jun 2006	40,000
Jul – Dec 2006	30,000
Jan – Jun 2007	65,000
Jul – Dec 2007	86,000
Jan – Jun 2008	70,000
Jul – Dec 2008	43,000
Jan – Jun 2009	24,613
	398,613

 (ii) During the period from 2007 to 2010, the Appellant only received cash payment of USD66,433, which were referred by Company A as 'Dividends', in relation to the above Grant Units.

 (iii) The Grant Units could not be sold or transferred or redeemed for cash and therefore, the Appellant was not able prior to the termination of his employment to realize the value ascribed to the Grant Units. The Appellant claimed that he was entitled to

be paid in cash for the amounts deducted from his annual compensation and purportedly 'paid' to him Grant Units, i.e. US$398,613 (equivalent to HK$3,101,209.14, converted at the rate of $7.78).

Commission in Grant Units under the 2009 Contract

(iv) For the period from 1 July to 31 December 2009, Company A paid commission of US$225,094 to the Appellant in cash with the balance of US$37,906 purported to be awarded Grant Units ('the 2nd Commission 2009'). The amount of US$37,906 had been omitted by Company B in his 2010 Grant Units 'Combined Summaries'. The Appellant claimed against Company A for the unpaid portion of the 2nd Commission 2009 in the sum of US$37,906 (i.e. HK$294,908.68 equivalent, converted at the rate of $7.78).

(v) For the period from 1 January to 30 June 2010, Company A paid commission of US$105,670 to the Appellant in cash with the balance of US$28,940 purported to be awarded Grant Units ('the 1st Commission 2010'). The Appellant had not received any payment of cash with respect to the Grant Units. He claimed against Company A for the unpaid portion of the 1st Commission 2010 in the sum of US$28,940 (i.e HK$225,153.20 equivalent, converted at the rate of $7.78).

(vi) For the period from 1 July to December 2010, the Appellant calculated his commissions to be US$43,197 ('the 2nd Commission 2010'). The Appellant had not received the said commission payment which should have been due at the latest by 31 March 2011 (i.e before his termination of employment). The Appellant claimed against Company A for the unpaid 2nd Commission 2010 in the sum of US$43,197.

Shortfall in payment in lieu of notice ('PILON') and annual leave

(vii) When calculating the Appellant's average monthly and daily wages for the purposes of his PILON and accrued annual leave, Company A failed to include the commission payments and the travelling allowance earned by him.

(viii) The Appellant claimed for shortfall in PILON and annual leave as follows:

PILON = Average monthly wages x 6 months – amount paid
= $321,466.53 [Note 1] x 6 - $1,200,000 = $728,799.18

Annual leave = Average daily wages x 36 days – amount paid
= $10,568.763 [Note 2] x 36 - $236,713 =$143,762.47

Notes

(1) Average monthly wages = $3,857,598.40 [Note 3]/12 = 321,466.53

(2) Average daily wages = $3,857.598.40 [Note 3]/365 =10,568.763

		$
(3)	12 month Fixed Draw/Salary	2,400,000.00
	The 1st Commission 2010	1,047,265.80
	The 2nd Commission 2010	336,072.66
	Travelling allowance	74,260.10
	Total annual wages	3,857,598.56

(c) Subsequent to a call-over hearing held on 30 March 2012, the Appellant filed a supplemental statement in which he stated the following:

(i) 'The amounts which I am claiming (including the cash value of the Grant Units "awarded" to me by [Company A]) are amounts: (a) earned by me in the course of my employment with [Company A] in Hong Kong as part of my total annual compensation; and…'

(ii) 'Therefore, these Grant Awards were not a voluntary "purchase" from me but rather a mandatory allocation whose amount was deducted at source from my employment wages.'

(iii) '…I did not sign any Award Agreements relating to both US$37,906 and US$28,940 purportedly awarded to me in Grant Units [in relation to the 2nd Commission 2009 and the 1st Commission 2010 respectively] and I do not agree to being awarded the Grant Units instead of being paid the cash commission due and payable to me under the 2009 Contract.'

21. The Labour Tribunal ordered the matter to be transferred to the Court of First Instance of the High Court of the HKSAR. On 7 November 2012, the Appellant filed a Statement of Claim with the High Court. In his Statement of Claim, the Appellant made the following claims against Company A;

(a) Shortfall in commission due to him under the 2004 Contract

(i) Pursuant to the 2004 Contract, a percentage of around 10% of each payment awarded to him for each six month period was deducted or withheld by Company A and was not paid in cash to him. The amounts deducted from each payment for the payment periods up to 30 June 2009 were set out as stated below:

Payment period	Payment due date	Amount deducted by Company A
		USD
1 Jul–31 Dec 2005	31 Mar 2006	40,000
1 Jan–30 Jun 2006	30 Sep 2006	40,000
1 Jul–31 Dec 2006	31 Mar 2007	30,000
1 Jan–30 Jun 2007	30 Sep 2007	65,000
1 Jul–31 Dec 2007	31 Mar 2008	86,000
1 Jan–30 Jun 2008	30 Sep 2008	70,000
1 Jul–31 Dec 2008	31 Mar 2009	43,000
1 Jan–30 Jun 2009	30 Sep 2009	24,613
		398,613

(‘the 2004 Contract Deducted Sums’)

(ii) Instead of paying the 2004 Contract Deducted Sums to the Appellant in cash, Company A caused Company B to issue the Appellant with various Award Agreements granting him Grant Units, in which the purported value of the total award equated to the approximate sum deducted.

(iii) The Appellant signed the Award Agreements on various dates but at the material time, he was under the mistaken belief that Company A was legally entitled under the Hong Kong law and the 2004 Contract to award him Grant Units instead of paying him the percentage of the relevant payments due to him in cash. Prior to signing the 2004 Contract, he was told by Company A that it was mandatory for all employees of the company to receive part of their total annual compensation in Grant Units rather than in cash.

(iv) During the period from 2007 to 2011, the Appellant received payments on various dates of amounts which were referred to by Company A as ‘Dividends’ in relation to the Grant Units, totaling US$68,517. Apart from that, the Appellant had not received payment from Company A or Company B of any part of the 2004 Contract Deducted Sums.

(v) The 2004 Contract Deducted Sums constituted part of the Appellant’s remuneration under the 2004 Contract and fell within the definition of ‘wages’ as provided in the Employment Ordinance, which should have been paid to him within seven days of the due dates. As such, the Appellant claimed against Company A for the 2004 Contract Deducted Sums less the amount of ‘Dividends’ received plus interest thereon.

(vi) Further and in the alternative, if it were determined that the Appellant was bound by some or all the Award Agreements and was not entitled to repayment of the 2004 Contract Deducted

Sums, the Appellant should be entitled to payment from Company A in cash of any amount equivalent to the value of the Grant Units and Grant Tax Payment Account under the Award Agreements as at the date of termination of his employment. The Appellant put forth, *inter alia*, the following arguments:

- The Appellant was not able prior to termination of his employment to realize the purported value of the Grant Units or the Grant Tax Payment Account with Company A caused to be issued in lieu of paying him his cash compensation earned in Hong Kong.

- The awards made under the Award Agreements, if enforceable, were granted to the Appellant by Company A as part of his annual compensation and formed part of his contract of employment and the sums should be due to him on termination.

(b) Shortfall in commission due to him under the 2009 Contract

(i) Pursuant to the terms of the 2009 Contract, the Appellant was entitled to be paid commission payment. In breach of the 2009 Contract, Company A deducted and did not pay to the Appellant the 2nd Commission 2009 and the 1st Commission 2010 in full.

The amounts deducted were set out as stated below:

Payment Period	Amounts deducted by Company A
	US$
1 Jul - 31 Dec 2009	37,906
1 Jan- 30 Jun 2010	28,940
	66,846 ('the 2009 Contract Deducted Sums')

(ii) Instead of paying the 2009 Contract Deducted Sums, Company A caused Company B to issue the Appellant with an Award Notification dated 12 October 2010 in which it purported to award the Appellant a grant of Grant Units for a total award of US$28,940. The Appellant did not sign the Award Notification.

(iii) The 2009 Contract Deducted Sums formed part of the wages due to the Appellant, which should have been paid to him within seven days of the respective due dates. However, the Appellant had not received any payment from Company A nor Company B. As such, the Appellant claimed against Company A for loss and damages in respect of the 2009 Contract Deducted Sums.

(iv) In breach of contract, Company A also failed to pay the Appellant the 2nd Commission 2010 in the sum of US$43,197 for the period from 1 July to 31 December 2010.

(c) Shortfall in PILON and accrued annual leave

(i) In calculating the Appellant's PILON and accrued annual leave, Company A failed to include the commission payments earned by the Appellant in the 12 months immediately preceding the termination date (i.e. from 14 June 2010 to 15 June 2011), which formed part of the Appellant's wages for that period.

(ii) The Appellant claimed for shortfall in PILON and annual leave as follows:

PILON = Average monthly wages x 6 months – amount paid
= $315,531.06 [Note 1] x 6 - $1,200,000 =$693,186.36

Annual leave = Average monthly wages x 36 days – amount paid
= $10,373.62 [Note 2] x 36 - $236,713 =$136,737.32

Notes

(1) Average monthly wages = $3,786,372.66 [Note 3] /12 =$315,531.06

(2) Average daily wages = $3,786,372.66 [Note 3] /365 =$10,373.62

		$
(3)	12 month Fixed Draw/Salary	2,400,000.00
	The 1st Commission 2010	1,050,300.00
	The 2nd Commission 2010	336,072.66
	Total annual wages	3,786,372.66

22. The Appellant, Company A and Company B ultimately entered into a settlement agreement on 2 May 2013 ('the Settlement Agreement'). The Settlement Agreement contained, *inter alia*, the following:

(a) Settlement and Discontinuance (Clause 2)

'2.2 In consideration of

(i) [The Appellant] and [Company B] executing a Partnership Separation Agreement in the form set out in Schedule A of this Agreement ("PSA"); and

(ii) [The Appellant] agreeing to waive and discontinue his claims against [Company A] in the Action; and

(iii) [The Appellant] undertaking not to apply to join [Company B] as a party to the Action and to discontinue all threatened claims against [Company B] in the Action; and

(iv) The Parties agreeing to the release and waiver of Claims and confirmations as set out in Clauses 3.1 and 3.2 below; [Company A] will pay [the Appellant], on behalf of itself and [Company B], … the following sums, totaling **US$888,500** (Eight Hundred Eighty Eight Thousand and Five Hundred United States Dollars)(the **"Settlement Sum"**), set out below:

(a) US$350,000 being an amount equivalent to [the Appellant's] original capital contribution to [Company B] (net of all applicable taxes and withholdings) in respect of his investment;

(b) US$350,000 by way of compromise and abrogation of the remainder of [the Appellant's] claims against [Company A] and in consideration of the further agreements made in this Settlement Agreement and the PSA; and

(c) US$188,500 by way of contribution to [the Appellant's] legal fees and expenses.

Save as provided in 2.2(a) above, each party shall be responsible for their own tax and withholding (if any) with respect to the Settlement Sum. For the avoidance of doubt, [the Appellant] will be responsible for his own Salaries Tax (if any) that may be payable to the Inland Revenue Department in Hong Kong on any part of the Settlement Sum.'

(b) Waiver and Release (Clause 3)

'3.1 In consideration of the agreement by [Company A] and [Company B] to pay [the Appellant] the Settlement Sum, …[the Appellant] fully and finally settles and irrevocably releases and waives all and/or any present, contingent and future Claims (whether or not in contemplation of the Parties as at the date of this Agreement), touching upon, whether directly or indirectly, the Employment or its termination, the Grant Units or Investment in [Company B], the Partnership Agreement and the Partnership or the Action that [the Appellant] may have, may have had or may hereafter have, against [Company A],

[Company B] and/or any of its or their Associated Companies or Affiliates.

3.2 In consideration of the terms of this Agreement,… each of [Company A] and [Company B] fully and finally settle and irrevocably release and waive all and/or any present, contingent and future Claims (whether or not in contemplation of the Parties as at the date of this Agreement), touching upon, whether directly or indirectly, the Employment or its termination, the Grant Units or Investment in [Company B], the Partnership Agreement and the Partnership or the Action that [Company A], [Company B] and/or any of its or their Associated Companies may have, may have had or may hereafter have, against [the Appellant]. [Company A] and [Company B] confirm that they are not, at the date of this Agreement, aware of any known complaints, actions, suits, causes or action or other liabilities against [the Appellant].'

23. The Assessor agreed that a portion of the First Sum should be attributable to the shortfall in PILON. The Assessor wrote to the Appellant explaining her view and suggested that the 2011/12 additional Salaries Tax Assessment be revised as follows:

	$
Additional income previously assessed	2,715,790
Less: Portion attributable to shortfall in PILON (Note 1)	442,514
	2,273,276

Notes:

(1) The First Sum x amount claimed as shortfall in PILON/total amount claimed
= 2,715,790 x 693,186.36 / 4,254,204.86 (Note 2)
= 442,514

(2) Total amounts claimed in the Statement of Claim filed with the High Court

	$
- Shortfall in commission under the 2004 Contract [US$(398,613 – 68,517.03) at 7.78]	2,568,146.64
- The 2009 Contract Deducted Sums [US$(37,906 + 28,940) at 7.78]	520,061.88
- The 2nd commission 2010 (US$43,197 at 7.78)	336,072.66
- Shortfall in PILON	693,186.36
- Shortfall in accrued annual leave	136,737.32
	4,254,204.86

24. The Appellant refused to withdraw the objection and put forward the following contentions:

(a) '[The First Sum] was clearly stated to be in abrogation of all my rights and claims in the Action thence shall not be subject to tax notwithstanding that the underlying claims were for amounts related to my Employment. In other words, this Settlement Sum shall not be taken into account as Salaries Tax but only being in settlement of all the claims and to indemnify me of my subsequent rights. It was a payment made by way of compromise and abrogation of my legal rights and claims raised in court proceeding against [Company A] and [Company B]'.

(b) 'There was no particular calculation formula leading to the Settlement Sum. Both parties agreed to settle all disputes by agreeing a lump sum. The breakdown stated in the Settlement Agreement being indicative. In my opinion and if based only to my claims then I should have been rewarded much more than the Settlement Sum agreed. A gross sum close to at least US$1,150,000 would have been more appropriate (according to me) to include all of my Partnership monies, the Grant Units, US Tax Refunds, subsequent missing bonuses, my US/UK and HK lawyer fees, interest, etc. Instead, and in order to settle all matters 'quietly' and to save time and costs and to avoid uncertainty surrounding the disputes between the parties, both parties finally agreed to a "global" sum of US$888,500.'

(c) 'If I had not decided to "sue" my former Employer [Company A], then we would have not come to this Settlement Agreement. In other words, I "only" had this indemnity because of / thanks to the lawsuit (and not "from my employment"). [Company A] would have never agreed to pay me my due otherwise … Additionally, I'd like to specify that [the First Sum] is much lower than the amounts that would or should have been paid to me pursuant to my entitlement under [the 2004 Contract] and [the 2009 Contract], which confirms that this is not a payment from my employment. This sum was clearly paid in consideration of the abrogation of my rights, rather than in satisfaction of the rights which had accrued to me, under the employment contracts. [The First Sum] accordingly come "outside" the charge to Salaries Tax contained in Section 8(1).'

(d) '…[the First Sum] was obviously to compensate me from my Partnership entitlement (i.e. to "buy me out" of [Company B] Partnership), from lost US Tax Refunds, interests/dividends (from my Investment in [Company B]) as well as Payment in Lieu of Notice ("PILON"). And it is without doubt that this sum included the full amount of the PILON, i.e. HK$693,186.36 since this is a mandatory termination payment. In any event, the total amount of [Grant Units] itself already covers [the First Sum] that you are disputing here, whatever the apportionment of PILON that you are computing.'

(e) 'Nevertheless, I concur that my underlying claims in the Labour Tribunal and the High Court were for amounts related to my Employment but *only* because this was part of the strategy opted by my lawyers to get the claim "exclusively" processed here in Hong Kong (rather than in the USA) so as to reclaim my Partnership monies. Indeed, it was considered that I might have to bring my claims not only in Hong Kong but also or rather in the USA, in [State J] where the [Company B] Partnership is originated and based. …You do understand that starting or having to bring a lawsuit in the USA (against [Company B]) would have been very inconvenient and costly to me while residing in Hong Kong (with multiple trips over there, flight fares, hotel accommodation, US legal fees, not to mention different jurisdiction and laws, etc.) My lawyers and I wanted to avoid that and here was the true nature of my claims in the Labour Tribunal and the High Court.'

(f) 'Conversely, and simply put, the main strategy of the Defendants [Company A/Company B] was to focus on [Company B] Partnership (a [State J] Limited Partnership) by shifting the debate into jurisdiction matter and by claiming that the courts and tribunal of Hong Kong had no jurisdiction to rule on any matters related to the Partnership / [Grant Units] arrangement.'

(g) 'Had the Court ruled in my favour and re-qualified the [Grant Units] as Salaries then I guess I would have been liable to Salaries Tax. However, [Company A/Company B] have denied my claims all the way through and we will never know the outcome of the trial since we came to agree on an "out-of-court" settlement. Again, [the First Sum] was not an emolument "from employment" (save and except for the PILOP part) but attributable to something else, i.e. mainly from my [Company B] Partnership Separation Agreement (compensation and abrogation of my rights and entitlement in [Company B] Partnership).'

(h) 'Obviously but mistakenly, the IRD is disputing the nature of [the First Sum] suggesting lack of clarity (but we believed that the Settlement Agreement and [Partnership Separation Agreement] were clear enough) and making the wrong assumption that this is a sum from my employment based on the Statement of Claim (before the courts) and exclusively from the Employment point of view but without taking the [Company B] Partnership (matter) into account then ignoring the true purpose of my Claim. In other words, you have misunderstood or failed to understand the true nature of my Claim in the Labour Tribunal and High Court, or the rationale behind the strategy adopted by my lawyers … The real basis of my Claim in the Labour Tribunal and High Court is, was and has always been the failure by [Company B/Company A] to repay or compensate me from

my [Company B] Partnership Grant Units and Investment in [Company B]. Had [Company B] been a listed public company I could have sold my [Grant Units] shares freely in the Marketplace…'

(i) Having maintained the view that [the First Sum] falls outside the test, the Appellant pointed out that the exchange rate of US$1 to HK$7.78 was purely indicative. The actual exchange rate used was US$1 to HK$7.7594. Hence, in calculating the portion attributable to PILON, the latter exchange rate should be used.

25. In response to the Assessor's enquiries, Company A provided the following information and documents:

(a) Statement filed by Company A to the Labour Tribunal in response to the Appellant's Statement of Claim. In the statement, Company A stated the following:

(i) The awarding of Grant Units was a form of remuneration consistent with section 28(1) of the Employment Ordinance.

(ii) Company A provided the following amounts to Company B to issue the Gross Awards which the Appellant received during his employment:

Dated of award	Gross Award (US$)
31 December 2005	40,000
1 September 2006	40,000
1 April 2007	30,000
1 September 2007	50,000
1 April 2008	70,000
1 April 2009	43,000
1 September 2009	24,613
1 August 2010	28,940

(iii) For the period from 1 July to 31 December 2010, the Appellant was not entitled to commission payment. The reason for this was that 50% of the net revenue generated by his desk less the total expenses of the desk resulted in a deficit. Hence, the commission revenue generated by his desk was not sufficient for a discretionary payment to be paid.

(iv) Both the discretionary commission payment and the benefits of return flights did not fall within the definition of 'wages' in section 2(1) of the Employment Ordinance and should not be included in the calculation of monthly average wages and daily average wages.

(v) In the alternative, if the Labour Tribunal concluded that the commission payments did fall into the definition of 'wages', for the purpose of calculation of PILON and accrued untaken annual leave, the monthly average wages and daily average wages should be the average wages for 12 complete months immediately before the date of notification, i.e. from 1 June 2010 to 31 May 2011. Accordingly, any shortfall in PILON should be calculated as follows:

Average monthly wages x 6 months – amount already paid
= $211,460.38 [Note 1] x 6 - $1,200,000 = $68,762.28

Notes		$
(1)	12 month Fixed Draw/salary	2,400,000.00
	Discretionary payment	
	- 1 June to 30 June 2010 [Note 2]	137,170.92
	- 1 July to 31 December 2010 [Note 3]	0.00
	- 1 Jan to 31 May 2011 [Note 4]	0.00
		2,537,170.90
	Average monthly wage	211,460.38

(2) Only one-sixth of the discretionary payment which was actually paid to the Appellant for the period from 1 January 2010 to 30 June 2010 should be adopted.

(3) Company A determined that the Appellant was not entitled to any discretionary payment as his desk resulted in a deficit.

(4) The Appellant was not entitled to any discretionary payment because the 2009 Contract provides that no discretionary payment would be awarded if the Appellant was no longer employed by Company A on the date of payment.

(b) Redacted correspondences regarding the negotiation of the settlement sum as follows

(i) A letter dated 3 October 2010 from Company K, solicitors representing the Appellant to Company B, which showed that the Appellant agreed to enter into a global separation agreement on a settlement sum of US$900,000 (which represents a reduction of his total claims for return of capital contribution of US$350,000 and claims made in the Labour Tribunal totaling US$620,524) and reimbursement for all legal fees.

(ii) A letter dated 25 October 2012 from Company K to Company L, which showed that the Appellant's claims lodged in the Labour Tribunal consisted of the following:

	US$
Value of Grant Units awarded between 2005 and 2008	398,613
Unpaid commission between 01-07-2009 to 30-06-2010 (37,906 + 28,940)	66,846
Unpaid commission between 01-07-2010 to 31-12-2010	43,197
Shortfall in PILON	93,436
Shortfall in accrued annual leave	18,432
	620,524

(iii) A letter dated 18 February 2013 from Company M, acting for Company A, to Company K, which showed that Company A offered a settlement sum of US$750,000 (including interest and costs) as full and final settlement of the Appellant's claims under the action in the Court of First Instance of High Court and in respect of his capital contribution in Company B.

(iv) A letter dated 25 February 2013 from Company K to Company M, which showed that the Appellant offered a settlement sum of US$800,000 plus cost.

(v) A letter dated 4 March 2013 from Company M to Company K, which showed that Company A offered a settlement sum of US$850,000 inclusive of costs and interest.

(vi) A letter dated 6 March 2013 from Company K to Company M, which showed that Appellant counter-offered a settlement sum of US$880,000 inclusive of costs and interest.

(vii) A letter dated 8 March 2013 from Company M to Company K, which showed that Company A agreed to the Appellant's counter-offer of a settlement sum of US$880,000 inclusive of costs and interest.

(viii) A letter dated 20 March 2013 from Company K to Company M, which showed that Appellant requested for an additional compensation of US$8,500 for loss of refund of US taxes.

(ix) An email dated 12 April 2013 from Company K, which showed that an additional sum US$8,500 had been included in the Settlement Agreement.

26. The Assessor considered that the 2011/12 Additional Salaries Tax Assessment should be revised as follows:

		$
Additional income previously assessed		2,715,790
Less:	Portion attributable to shortfall of PILON (Note 1)	443,460
		2,272,330
Additional tax payable		340,849

Notes:

(1) The Sum x amount claimed as shortfall in PILON/ total amount claimed
= 2,715,790 x 693,186.36 / 4,245,137.99 (Note 2)
= 443,460

(2) Total amounts claimed in the Statement of Claim filed with the High Court

	$
- Shortfall in commission under the 2004 Contract [US$(398,613-68,517.03) at 7.7594]	2,561,346.66
- The 2009 Contract Deducted Sum [US$(37,906+28,940) at 7.7594]	518,684.85
- The 2nd commission 2010 (US$43,197 at 7.7594)	335,182.80
- Shortfall in PILON	693,186.36
- Shortfall in accrued annual leave	136,737.32
	4,245,137.99

Authorities submitted by the parties

27. The Respondent's list of authorities, which was not disputed by the Appellant, reads as follows:

Inland Revenue Ordinance (Chapter 112)

(a) Inland Revenue Ordinance (Chapter 112): Sections 8, 9, 11B, 11D, 12, 68, 68AA, 68AAB and Schedule 5, Part 1

Board of Review Decisions

(b) D76/98, IRBRD, vol 13, 420

(c) D30/11, (2011-12) IRBRD, vol 26, 524

(d) D33/13, (2014-15) IRBRD, vol 29, 84

Hong Kong Tax Cases

(e) CIR v Humphrey 1 HKTC 451

(f) CIR v Robert P Burns 1 HKTC 1181

(g) CIR v Elliott [2007] 1 HKLRD 297

(h) Fuchs v CIR (2011) 14 HKCFAR 74

UK Tax Cases

(i) Brown v Bullock 40 TC 1

(j) Humbles v Brooks 40 TC 500

28. The Appellant did not provide any authority to substantiate his appeal.

Relevant Provisions of the Inland Revenue Ordinance

29. The following provisions of the Inland Revenue Ordinance are relevant and apply in this appeal:

(a) Section 8(1) provides *inter alia*:

‘*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.....’

(b) Section 9(1)(a) provides the definition of income from employment which includes *inter alia*, ‘*any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others, except....*’.

(c) Section 11B provides *inter alia* that ‘*The assessable income of a person in any year of assessment shall be the aggregate amount of income accruing to him from all sources in that year of assessment.*’

(d) Section 11D provides *inter alia* that ‘*For the purpose of Section 11B-*

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

Provided that .....

(ii) ... any payment made by an employer to a person after that person has ceased... to derive income which, if it had been made on the last day of the period during which he derived income, would have been included in that person's

assessable income for the year of assessment in which he ceased….. to derive income from that employment, shall be deemed to have accrued to that person on the last day of that employment.'

(e) Section 12(1) provides *inter alia* that

'*In ascertaining the net assessable income of a person for any year of assessment, there shall be deducted from the assessable income of that person-*

(a) *all outgoings and expenses, other than expenses of a domestic or private nature and capital expenditure, wholly, exclusively and necessarily incurred in the production of the assessable income;*'

(f) Section 68(4) provides *inter alia* that:

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

(g) Section 68(9) provides *inter alia* that:

'*Where under subsection (8), the Board does not reduce or annul such assessment, the Board may order the Appellant to pay as costs of the Board a sum not exceeding the amount specified in Part 1 of Schedule 5, which shall be added to the tax charged and recovered therewith.*'

The amount specified in Part 1 of Schedule 5 is $25,000.

Relevant Authority on Income chargeable to Salaries Tax

30. As per Mr Justice Ribeiro, PJ in Fuchs v Commissioner of Inland Revenue[6],

'*Income chargeable under [Section 8(1) of the Ordinance] is likewise not confined to income earned in the course of employment but embraces payments made (in Lord Radcliffe's terms) "in return for acting as or being an employee", or (in Lord Templeman's terms) "as a reward for past services or as an inducement to enter into employment and provide future services". If a payment, viewed as a matter of substance and not merely of form and without being "blinded by some formulae which the parties may have used", is found to be derived from the taxpayer's employment in the abovementioned sense, it is assessable. This approach properly gives effect to the language of s.8(1).*'[7]

[6] (2011) 14 HKCFAR 74

[7] Paragraph 17 at page 84

'*It is worth emphasizing that a payment which one concludes is "for something else" and thus not assessable, must be a payment which does not come from within the test. As Lord Templeman pointed out, it is only where "an emolument is not paid as a reward for past services or as an inducement to enter into employment and provide future services but is paid for some other reason, [that] the emolument is not received 'from the employment'." Thus, where a payment falls within the test, it is assessable and the fact that, as a matter of language, it may also be possible to describe the purpose of that payment in some other terms, e.g. as "compensation for loss of office", does not displace liability to tax. The applicable test gives effect to the statutory language and other possible characterisations of the payment are beside the point if, applying the test, the payment is from employment.*'[8]

'*in situations like those considered above, since the employment is brought to an end, it will often be plausible for an employee to assert that his employment rights have been "abrogated" and for him to attribute the payment received to such "abrogation", arguing for an exemption from tax. It may sometimes not be easy to decide whether such a submission should be accepted. However the operative test must always be the test identified above, reflecting the statutory language: In the light of the terms on which the taxpayer was employed and the circumstances of the termination, is the sum in substance "income from employment"? Was it paid in return for his acting as or being an employee? Was it an entitlement earned as a result of past services or an entitlement accorded to him as an inducement to enter into the employment? If the answer is "Yes", the sum is taxable and it matters not that it might linguistically be acceptable also to refer to it as "compensation for loss of office" or something similar. On the other hand, the amount is not taxable if on a proper analysis the answer is "NO". As the "abrogation" examples referred to above show, such a conclusion may be reached where the payment is not made pursuant to any entitlement under the employment contract but is made in consideration of the employee agreeing to surrender or forgo his pre-existing contractual rights. In the present appeal, the principal dispute between the taxpayer and the Revenue involves rival contentions along the aforesaid lines*'[9]

Relevant Authorities on Settlement Payment following legal proceedings

31. In D76/98[10], the Board held that:

'*the [settlement sum], which was expressly paid and received in full and final settlement of the Taxpayer's claims against [the employer], took its*

[8] Paragraph 18 at page 84
[9] Paragraph 22 at page 89
[10] IRBRD, vol 13, 420

> *nature from the substance of those claims. To a large extent those claims represent items of income which would have been liable to salaries tax if received in the normal course.*[11]'

> '*It is true that the Taxpayer did not get everything that he claimed and that [the settlement sum] falls far short of the total amount of his various claims. However this does not change the nature of the [settlement sum] as being a payment which, in great part, represented compensation for non-receipt of certain items of income from employment. … The dispute between an employee and his employer could not have changed the nature of the payment the employee finally received if some of the items he originally claimed pursuant to the terms of the employment would be taxable.*[12]'

32. In D30/11[13], the Board held that:

> '*However, in any event, regard must be had to the fact that when [the taxpayer] filed the claim at the Labour Tribunal, the sum claimed was clearly identifiable as a claim for wages that were due.*[14]'

> '*We need to look very carefully at the nature of Sum A and in turn, we have come to the conclusion that Sum A was undoubtedly an amount which Company C was liable to pay under the terms of the Employment Contract irrespective of such proceedings being instituted. Hence we conclude that Sum A is indeed taxable.*[15]'

33. In D33/13[16], the taxpayer disputed that the settlement payment, being not income from employment, was capital in nature and not taxable as they were paid to the taxpayer for the purpose of relinquishing and settling all claims and counterclaims asserted. The Board dismissed the appeal and held that

> '*Each of the components of the sum of USD7,250,000 was offered and paid the [taxpayer] in return for his having acted as an employee. The [taxpayer's] divers entitlements arose from various terms of his employment. The components were all derived "from his employment". The [taxpayer] relinquished nothing and surrendered no rights. The payments arose from the employment and not from "something else"*[17].'

Legal Principles on Deduction of relevant fees and expenses

34. Section 12(1) of the Ordinance provides *inter alia* that:

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[11] Paragraph 43 at page 432
[12] Paragraph 44 at page 432
[13] (2011-12) IRBRD, vol 26, 524
[14] Paragraph 10 at page 529
[15] Paragraph 27 at page 531
[16] (2014-15) IRBRD, vol 29, 84
[17] Paragraph 12 at page 90

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

35. The incurred expenses must be:

(a) Other than expenses of a domestic or private nature;

(b) Other than capital expenditure;

(c) Wholly, exclusively and necessarily incurred; and

(d) Incurred in the production of the assessable income.

36. The Court of Appeal in CIR v Robert P Burns[18] allowed the appeal taken by the Commissioner consequent upon the Board's decision that the legal costs incurred by the taxpayer in his successful appeal against the disqualification decision made by the Royal Hong Kong Jockey Club was deductible as far as Salaries Tax was concerned. The Court agreed with the legal principles taken in Lunney v Commissioner of Taxation[19] that there was an important distinction between 'an expense incurred in gaining income' and 'one incurred necessarily for the purposes of gaining it'[20]. Accordingly, the Court held that the legal fees incurred by the taxpayer for securing his qualification to earn his assessable income were not incurred in the production of the assessable income.

37. In D33/13[21], the taxpayer argued that the legal fees incurred by him in relation to the arbitration proceedings should be tax deductible under Section 12(1) of the Ordinance from the settlement payment which he obtained in the arbitration proceedings taken by him. The argument was rejected by the Board where the Board said[22]:

> '*We are bound by Robert P Burns. The legal fee was not within the bare physical or temporal limits within which the [taxpayer] performed his work or labour. More specifically, we find that the legal fee was not incurred in the performance of the [taxpayer's] employment duties and therefore not deductible. The legal fee does not satisfy the stringent section 12(1) requirement.*'

[18] 1 HKTC 1181
[19] (1957) 100 CLR 478
[20] First paragraph on page 1190
[21] (2014-15) IRBRD, vol 29, 84
[22] Paragraph 23 at page 93

Analysis and Discussion

38. Both the Appellant and the Respondent parties filed a written submission.

39. It is beyond doubt that the Appellant's claims filed with the Labour Tribunal which was subsequently transferred to the High Court were based on the alleged breach of the relevant payment clauses under the employment contract entered into between the Appellant and Company A or under the provisions of the Employment Ordinance, particulars of which are set out in paragraph 20(b) and paragraph 21 hereof.

40. Soon after the filing of the claims in the High Court, the Appellant through his Solicitors engaged an active settlement negotiation with the Solicitors for Company A though the Appellant's Solicitors wrote an offer to Group AB (Company A and Company B) as early as 3 October 2012[23].

41. The letters exchanged between their solicitors showed the following offers and counter-offers which led to a final settlement.

	Date	Sending Party	Amount proposed
1.	25-02-2013	Company K [24] to Company M[25]	US$800,000 (inclusive of interest) plus costs
2.	04-03-2013	Company M to Company K	US$850,000 inclusive of costs of US$150,000 (capped) and interest
3.	06-03-2013	Company K to Company M	US$880,000 inclusive of costs and interest
4.	08-03-2013	Company M to Company K	Acceptance of the offer dated 6 March 2013
5.	20-03-2013	Company K to Company M	Request for an additional compensation of US$8,500 for irrecoverable refunds
6	12-04-2013[26]	Company K to Company M	Noted that US$8,500 was to be included in the settlement

42. As revealed from the correspondences and the provisions of the Settlement

[23] Page 190 of R1 Bundle, see also paragraph 24(b) hereof
[24] Company K, Solicitors for the Appellant
[25] Company M, Solicitors for Company A's and Company B
[26] Email

Agreement, the final agreed settlement sums of US$888,500 comprised of (a) US$350,000 being return of the Appellant's capital contribution to Company B (in this Decision referred to as the 'Second Sum'), (b) US$350,000 (being the First Sum), for settling the Appellant's claims against Company A in the legal proceedings and (c) US$188,500 being contribution to the Appellant's legal fees and expenses[27] (referred to in this Decision as 'Agreed Costs'). In addition to the Settlement Agreement, the Appellant had to enter into the Partnership Separation Agreement simultaneously with Company B for the purposes of settling his claims.

43. It is noted that:

(a) pursuant to clause 2.2(a) of the Settlement Agreement, Company A (on behalf of itself and Company B) made the Second Sum to the Appellant which was agreed by the Appellant to be equivalent to the his original capital contribution to Company B (net of all applicable taxes and withholdings) in respect of his investment;

(b) pursuant to clause 2(c) of the Partnership Separation Agreement, the Second Sum represents the entire payment to be made by and/or owed in any manner (i) by Company B to the Appellant in connection with his interest in the Company B partnership, including, without limitation, any capital account, income, distributions, profits, earnings, interest, Post-Termination Payment and Grant Tax Payment Account……, and (ii) by Company A in relation to Partner's employment with Company A or its termination[28];

(c) pursuant to clause 2(d) of the Partnership Separation Agreement, in relation to the payment designated to be received under the Partnership Separation Agreement (i.e. the Second Sum), Appellant also agreed that on receipt of the Second Sum, he waives any right he may have (i) to be paid or be owed any money by Company B or to examine the books of Company B, demand any accounting by Company B, or to otherwise question any amount payable from Company B to the Appellant, whether pursuant to the terms of the Partnership Agreement or otherwise, and (ii) to be paid or owed any money by Company A[29]; and

(d) the Appellant undertakes to perform certain positive covenants and negative covenants as stated in the Partnership Separation Agreement.

44. The Respondent did not raise any tax on the Second Sum. The assessment under appeal is related to the First Sum only.

[27] Clause 2.2 of the Settlement Agreement
[28] Clause 2(c) of the Partnership Separation Agreement
[29] Clause 2(d) of the Partnership Separation Agreement

45. The Appellant contended that the First Sum should not be chargeable to tax because the payment of the First Sum relates to Termination or Partnership payments for compensation of the loss of the Appellant/Partner's Grant Units into Company B following its Employment Termination. The Appellant argued that with the termination of his employment, the Appellant 'automatically' ceased to be Partner in the Company B Partnership at the same time and all Partnership matters must be addressed directly with Company B and Company A will be dealing with Employment matters only. It is further the Appellant's case that any payments or claim relating to Company B Partnership were not made pursuant to Employment contracts but pursuant to the LPA[30]. In short, it is the Appellant's case that the First Sum was paid in relation to Termination or Partnership payments for compensation of the loss of the Appellant/Partner's Grant Units into Company B following its Employment Termination.

46. We cannot accept the submission made by the Appellant that the First Sum was paid in relation to Termination or Partnership payments for compensation of the loss of the Appellant/Partner's Grant Units into Company B following its Employment Termination for a couple of reasons.

47. First of all, there is no evidence whatsoever that the payment of the First Sum relates exclusively to Termination or Partnership payments for compensation of the loss of the Appellant/Partner's Grant Units into Company B following its Employment Termination as alleged.

48. Secondly, by reason of the clause 2.2(a) of the Settlement Agreement and section 2(a) of the Partnership Separation Agreement, the Second Sum, but not the First Sum, was paid in relation to Termination or Partnership payments for compensation of the loss of the Appellant/Partner's Grant Units into Company B following its Employment Termination as alleged. These two provisions apparently contradict the Appellant's allegation in this regard.

49. Thirdly, contrary to his submission, the Appellant agreed that the payment of the First Sum was for compromise and abrogation of the remainder of [the Appellant's] claims against Company A and in consideration of the further agreements made in this Settlement Agreement and the PSA[31]. According to clause 2.2 of the Settlement Agreement, the claims referred to in clause 2.2(b) means his claims against Company A in the Action[32].

50. It is therefore apparent that the First Sum was not paid in relation to Termination or Partnership payments for compensation of the loss of the Appellant/Partner's Grant Units into Company B following its Employment Termination as submitted by the Appellant.

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[30] Group AB Limited Partnership Agreement

[31] Clause 2.2 (b) of the Settlement Agreement

[32] 'Action' is defined in Recital F of the Settlement Agreement as HCA 1575 of 2012 (on transfer from LBTC 863/2012)

51. According to the Statement of Claim so filed, the Appellant claims against Company A for (a) damages for breach of contract and Employment Ordinance in respect of the 2004 Contract Deducted Sums of US$398,613 plus interest; (b) further and in the alternative to (a), payment of an amount equivalent to the value of the Grant Units and Grant Tax Payment Account; (c) damages for breach of contract and the Employment Ordinance in respect of the 2009 Contract Deducted Sums of US$66,846; (d) Damages for breach of contract in respect of the 2nd 2010 Commission Payment in the sum of US$43,197, (e) damages for breach of contract and the Employment Ordinance in respect of the outstanding PILON and Accrued Annual Leave Pay of HK$693,186.36 and HK$136,737.32, (f) in the alternative, for damages for breach of contract and the Employment Ordinance to be assessed; (g) Interest and (h) further or other relief; and (i) costs.

52. As discussed in the above, the Second Sum had already dealt with the Grant Units and Grant Tax Payment Account as well as the separation matters of Company B, which had been summarized and agreed by the Appellant and Company B. The payment of the First Sum therefore relates nothing with Company B as alleged, but relates to his claims against Company A in the Action only.

53. Based on the correspondences exchanged between the parties for the settlement negotiation and based on the provisions of the Settlement Agreement and the Partnership Separation Agreement, it is beyond any doubt that the First Sum was paid in settling the claims of the Appellant on the basis of his employment contract with Company A or the breach of the Employment Ordinance on the part of Company A, which were particularized in the Statement of Claim filed by the Appellant in the Action.

54. The bonuses or commission (being part of the First Sum) were payable to the Appellant due to his services performed to Company A. PILON and leave pay (being also part of the First Sum) were also payable to the Appellant upon his cessation of his employment of Company A. We agreed with the Respondent's submission that all those payments were rewards for the Appellant's services rendered to Company A, the sources of which were due to his employment of Company A.

55. The fact that the amount of the First Sum fell short of the total amount of the claims made by the Appellant would not change the nature of the First Sum as being a payment for the non-receipt of income from employment. The disputes between the Appellant and Company A, his employer, could not have changed the taxable nature of the First Sum if the First Sum was paid for those taxable items. Based on the test adopted in Fuchs v CIR,[33] we have no doubt that the First Sum was paid to the Appellant by Company A in relation to the past services provided to Company A as employee, and not paid in consideration of the Appellant agreeing to surrender or forgo or abrogate any of his pre-existing contractual rights.

56. The First Sum was paid to the Appellant after the cessation of his employment with Company A. According to Section 11D(b) proviso (ii), the First Sum is

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therefore deemed to have accrued to the Appellant on the last day of his employment, i.e. 16 June 2011. Likewise PILON is deemed to have accrued to him on 16 June 2011. According to the Respondent's assessing practice concerning PILON, PILON is exempted from Salaries Tax if it was accrued before 1 April 2012.

57. In our view the amount (after deducting the payment of PILON from the First Sum) should therefore be assessed in the year of assessment 2011/12 under section 11B of the Ordinance.

58. From the facts found by us, the Respondent had made an apportionment on the amount of PILON on the pro-rata basis of the total amount of PILON claim and the total amount settled between the parties. We find that the adjusted amount of PILON in the sum of HK$443,460 is fair and reasonable.

59. In the Second Ground of Appeal, the Appellant claimed that if the First Sum is found to be taxable, the First Sum included not only the settlement of Grant Unit Awards, but also settled a number of other claims which the Appellant was making against his former employers CompanyA/Company B, and should be deductible from assessment of Salaries Tax. The claims include but not limited to:

(a) Loss of refund of US Taxes;

(b) Shortfall in PILON amounting to HK$693,186.36;

(c) Interest Losses and Loss of Opportunity regarding voluntary investment of US$350,000 into Company B Partnership dated 17 April 2010;

(d) Loss of quarterly dividend payments and interest on the missing 2nd Commission 2010; and

(e) Additional claims related to interest, costs and further or other relief as set out in paragraphs (VI), (VII), (VIII) and (IX) of the Statement of Claim in the High Court dated 9 November 2012;

60. Furthermore, the Appellant submitted that the legal fees amounting to US$188,500 (equivalent to HK$1,462,647) ('the Agreed Costs'), which represent an important sum, should be deductible under section 12(1) of the Ordinance. These legal expenses were related to the court proceedings and therefore, were 'wholly, exclusively, and necessarily incurred in the production of the assessable income'.

61. With regard to the items of (a) loss of refund of US Taxes; (c) Interest Losses and Loss of Opportunity regarding voluntary investment of US$350,000 into Company B Partnership dated 17 April 2010; and (d) Loss of quarterly dividend payments and interest on the missing 2nd Commission 2010, we feel it is easy to reject such submission as there were no evidences whatsoever to substantiate the same.

62. Contrary to the Appellant's submission, by reason of the provisions of the Settlement Agreement, he agreed that the First Sum was to settle his claims in the Statement of Claim filed by him in the High Court Action. By reason of the provisions of the Settlement Agreement and Partnership Separation Agreement, the Appellant agreed that the Second Sum dealt with his investment with Company B. The Respondent did not make any assessment on the Second Sum which was used to deal with his investment with Company B. We therefore see no reason and logic why items (a), (c) and (d) set out in paragraph 59 hereof should be deductible from the First Sum for assessment of his Salaries Tax liability.

63. Apart from the First Sum and the Second Sum, a further sum of US$188,500 (being the Agreed Costs) was paid by Company A and/Company B to the Appellant by way of contribution to his legal costs and expenses. The First Sum, the Second Sum together with the Agreed Costs formed the whole amount of the Settlement Sum.

64. The Respondent did not make any assessment on the Agreed Costs received by the Appellant. There is no evidence whatsoever on the actual amount of legal costs incurred by the Appellant. For the purposes of discussion, let us assume that the actual amount of legal cost incurred is equal to the Agreed Costs. In this case, the Appellant suffered no loss in legal cost.

65. The Appellant is now arguing that the amount of legal cost paid should be deducted from assessment of Salaries Tax notwithstanding the fact he recovered the same in full at the end of the day. The argument is tantamount to asking the Board to give him deduction in the assessment of Salaries Tax notwithstanding the fact that he paid nothing. He is asking the Board to turn a blind eye on the receipt of the Agreed Costs. We cannot see how we can ignore the fact that the Agreed Costs were received by him under the Settlement Agreement. It is difficult to understand his reason and logic, if any, in his submission.

66. In any event, whether or not the Appellant recovered any legal costs (or the Agreed Costs) from Company A and/or Company B, the legal costs incurred by him to recover the Settlement Sum were not incurred in the performance of the Appellant's employment duties. The legal costs incurred (no matter the amount was) simply do not satisfy the stringent requirements of section 12 (1)(a) of the Ordinance and is therefore not deductible from assessment of his Salaries Tax liability by applying CIR v Robert P Burns and D33/13.

67. There was no evidence that interest was recovered from Company A. For the purposes of discussion, we feel even if interest was recovered, the interest came from the claimed amount which were taxable in nature. Accordingly, even if interest was recovered, it should not be deducted from assessing the Salaries tax liability of the Appellant.

68. We have already expressed our view on the apportioned amount of PILON and felt that it is fair and reasonable that the apportioned amount of PILON should be

deducted. The Respondent had made the adjustment thereof in the assessment under dispute. We feel therefore that there is no substance in the second Ground of Appeal.

69. By his third ground of Appeal, the Appellant argued that the First Sum was a payment related to non-compete post-termination restrictive covenants. So it is not an employment income (i.e. 'in return for acting as or being an employee' or ….. 'as reward for past services or as an inducement to enter into employment and provide future services') and therefore should be declared non-taxable.

70. As discussed above, the First Sum was not a payment in relation to the restrictive covenants stated in the Partnership Separation Agreement. The First Sum was for the purpose of settling his claims made in the High Court Action. If there were a payment to the Appellant in exchange for his covenants, the payment was the Second Sum. The Appellant agreed to the restrictive covenants, if any, imposed in the Partnership Separation Agreement on the basis of the payment of the Second Sum made to him by Company A and/or Company B, not on the basis of the payment of First Sum.

Conclusion and Disposition

71. We have carefully considered the oral and written submission of the Appellant, the facts of the case and all documents involved. For the reasons and analysis set out above, we reject each ground of appeal submitted by the Appellant. We do not find that the Appellant has discharged the burden that the assessment appealed against is excessive or incorrect. We accordingly dismiss the appeal and confirm the assessment appealed against as confirmed by the Deputy Commissioner on 22 September 2016.

Costs

72. If the Appellant fails in its appeal, the Board may order the Appellant to pay as costs of the Board a sum not exceeding the amount of $25,000 pursuant to section 68(9) of the Inland Revenue Ordinance.

73. The Appellant, being Position D on the Equity Derivatives desk, earned a substantial amount of annual income (in the order of million(s)) and is well educated. He should have the knowledge and ability of differentiating an appeal of merit or of no merit.

74. We reject each and every submission or ground of appeal advanced by the Appellant. In most cases, there was lack of evidence to substantiate those grounds. Apart from advancing an argument without evidence, he also twisted the fact to suit his argument. The true fact, as we have found, is that he was paid the Second Sum for entering into the Partnership Separation Agreement. However, he refrained from mentioning the Second Sum in his argument but tried his best to impress the Board that the First Sum was for that purpose and hence the First Sum was paid not in relation to any items of taxable nature. In short, the whole appeal is of no merits and unarguable. We rule that this appeal is frivolous and vexatious.

75. Substantial amount of public fund is incurred in the appeal. We therefore

see no reason why the general public has to bear the costs of the Board in dealing with this unmeritorious and unarguable appeal.

76. Pursuant to section 68(9) of the Ordinance, we order that the Appellant to pay a sum of HK$10,000 as costs of the Board, and this sum of HK$10,000 be added to the tax charged and recovered therewith.