

Case No. D22/18

Salaries tax – whether income arose or derived from any office or employment of profit – whether ex-gratia payment paid on employee’s resignation was such income – Inland Revenue Ordinance (‘the Ordinance’) section 8

Panel: Elaine Liu Yuk Ling (chairman), Au Hiu Lam Helen and Leung Wai Lim.

Date of hearing: 25 October and 11 December 2017.

Date of decision: 27 February 2019.

The Appellant was employed by a company since 2008. As part of the terms of his employment contract, the Appellant would be eligible for stocks of the company subject to satisfactory performance. On 30 December 2013, the Appellant and his employer company entered into an agreement, by which the Appellant gave notice to resign from January 2014. The employer company agreed to pay, amongst other payments, (i) a sum equal to 3 months of the Appellant’s salary as one-off ex-gratia payment; and (ii) ex-gratia discretionary payment, inclusive of the Appellant’s entitlement to the company’s stocks. The Assessor raised Salaries Tax Assessment for the 2012/13 year of assessment based on the employer company’s information. The Appellant appealed against the assessment, arguing that (i) the ex-gratia payment equal to 3 months’ salary should not be subject to Salaries Tax Assessment; and (ii) stock value in the sum of HK\$7,320 was already included in the assessment of the 2013/14 year of assessment.

Held:

1. The ex-gratia payment equal to 3 months’ salary was in substance derived from the Appellant’s employment with the employer company, and was a payment made to the Appellant in return for his acting as or being an employee. The Appellant did not surrender any pre-existing contractual rights to earn the ex-gratia payment. Thus, the ex-gratia payment was subject to Salaries Tax Assessment under section 8 of the Ordinance (Fuchs v Commissioner of Inland Revenue [2011] 2 HKC 422 applied).
2. The burden of proof rested with the Appellant to show that the stock value was repeatedly counted in the 2013/14 year of assessment. The Appellant did not put forward any evidence to show that was such the case. Hence, the appeal on the assessment of the stock value must fail.
3. The Appellant chose to lodge the appeal on the basis of his assumption or speculation without supporting evidence. He was evasive and refused to answer directly in cross examination, which unnecessarily prolonged the

hearing before the Board. The Appellant's conduct wasted the Board's resources.

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

Cases referred to:

Fuchs v Commissioner of Inland Revenue [2011] 2 HKC 422
Hochstrasser v Mayes [1960] AC 376
Shilton v Wilmshurst [1991] 1 AC 684
Mairs v Haughey [1994] 1 AC 303
EMI Group Electronics v Coldicott [1999] STC 803
Hunter v Dewhurst (1931) 16 TC 605
Henley v Murray (1950) 31 TC 351
Dale v de Soissons (1950) 32 TC 118
Comptroller-General of Inland Revenue v Knight [1973] AC 428
D167/98, IRBRD, vol 14, 25
D4/05, (2005-06) IRBRD, vol 20, 256
D8/13, (2013-14) IRBRD, vol 28, 270

Appellant in person.

Cheung Ka Yung, Chow Cheong Po and Chiu Ming Wai, for the Commissioner of Inland Revenue.

Decision:

A. The Appeal

1. The Appellant appeals against the determination of the Deputy Commissioner of Inland Revenue dated 1 June 2017 ('Determination') on two items in his Salaries Tax Assessment for the year 2013/14, namely:

- (1) a sum of HK\$169,255 ('the Sum'), equaling to 3 months' salary, paid by the Appellant's then employer to him, and
- (2) value of the stock in the sum of HK\$7,320 ('Stock Value').

2. The Appellant's grounds of the appeal stated in his Notice of Appeal are:

- (1) The Sum was solely a compensation given to him, but not an employment benefit paid as a result of him having been fired by his employer. He signed the separation letter involuntarily as his health at that time was at risk. He has filed a legal action but eventually discontinued because the contingent cost might make him bankrupt.

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His income after 2014 was greatly reduced. His financial position has been worsened since he lost this job.

- (2) The Stock Value was never paid to him. The Stock Value was repeatedly embedded into the HK\$24,255 in the year 2013/2014. He said that he had never got hold of the shares nor its benefits.

3. Pursuant to section 68(4) of the Inland Revenue Ordinance, the Appellant bears the burden of proving that the Assessments are excessive or incorrect.

B. Facts

4. By an employment letter and an agreement both dated 31 July 2008 (collectively ‘the Employment Contract’), the Appellant was employed by Company A (‘the Employer’) as Position B commencing from 11 August 2008.

5. The terms and conditions of the Employment Contract included:

- (1) In addition to the basic salary, the Appellant would be eligible for an incentive bonus in accordance with the Company C Incentive Program.
- (2) The Appellant would be eligible for the restricted stock units (‘RSU’) subject to his satisfactory performance and approval of the board of directors of Company C. The RSU would be vested over a four-year period.
- (3) After the first six months of employment with the Employer, either the Employer or the Appellant may terminate the employment by giving to the other party three months’ notice in writing or paying to the other party a payment in lieu of notice.

6. The Appellant was awarded US\$7,400 under the Company C long-term incentive plan for 2011. Pursuant to the RSU Agreement, the award was converted into 284 RSU which was granted to the Appellant on 14 February 2011. The conversion was calculated by dividing US\$7,400 with US\$26.07 being the market price per Company C common stock (‘Company C Stock’) on the date of grant.

7. On 5 February 2012, 71 RSU were vested in the Appellant and 71 units of Company C Stock were released to the Appellant at a value of HK\$10,672.

8. On 5 February 2013, another 71 RSU were vested in the Appellant and 71 units of Company C Stock (valued at HK\$7,320) were released to the Appellant. This sum of HK\$7,320 is the Stock Value referred to in paragraph 1(2) above, which is one of the subject matters in this appeal.

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9. The Appellant had previously raised objection to the Salaries Tax Assessment on the Stock Value for the year 2012/13 and failed. By a determination dated 2 March 2015 ('Previous Determination'), the Deputy Commissioner of Inland Revenue ('Deputy Commissioner') confirmed the Salaries Tax Assessment which included the Stock Value as part of the Appellant's assessable income. No appeal was raised by the Appellant against the Previous Determination. There is no dispute that under section 70 of the Inland Revenue Ordinance, the Salaries Tax Assessment for the year 2012/13 became final and conclusive.

10. On 30 December 2013, the Appellant and the Employer had entered into a separation agreement ('Separation Agreement').

11. The relevant terms of the Separation Agreement are as follows:

- (1) '2.1 On or about December 30th, 2013, [the Appellant] gave notice to [the Employer] of his resignation from [Company A] by giving three (3) months' notice from 1 January 2014.'
- (2) '2.2 [The Employer] accepted [the Appellant's] resignation with the mutual agreement between the Parties as follows:
 - (a) [the Appellant] will work in the office of [the Employer] until February 28th, 2014 ("the Last Working Day"), and
 - (b) [the Appellant] will be on "Garden Leave starting March 1st through March 31st, 2014 [The Appellant's] employment with [the Employer] will be terminated on the close of business on March 31st, 2014 (the "Termination Date").'
- (3) '2.3 Without admission of liability, [the Employer] will pay to [the Appellant] such amount as set out in Appendix A in full and final settlement of any and all contractual and statutory or other entitlements that [the Appellant] has, or may have, from [the Employer] relating to the Termination as follows:
 - (i) Such sum representing the base salary during January 1st, 2014 – March 31st, 2014 (inclusive);
 - (ii) Such sum representing the accrued but unconsumed annual leave at the Termination Date;
 - (iii) Such sum representing the goodwill ex-gratis one-time payment; and
 - (iv) Such ex-gratis discretionary payment inclusive of any variable pay entitlement under the Pitney Bowes Incentive Programs.

(collectively the “Termination Payment”)

- (4) ‘2.6 [The Appellant] acknowledges and agrees that to the extent any of the Restricted Stock Unit (“RSU”) awarded to him pursuant to the applicable Restricted Stock Unit agreement between [the Appellant] and [the Employer] have not vested on or before the Termination Date, such RSU shall be forfeited accordingly.’

12. Appendix A to the Separation Agreement provides as follows:

- ‘1. Subject to the provisions in the Agreement, [the Appellant] shall receive the Termination Payment as follows:
- (i) Such sum representing the base salary during January 1st, 2014 – March 31st, 2014 (inclusive) – HK\$169,225;
 - (ii) Such sum representing the accrued but unconsumed annual leave at the Termination Date – [to be determined];
 - (iii) Such sum representing the goodwill ex-gratis payment – HK\$169,225; and
 - (iv) Such ex-gratis discretionary payment which is inclusive of any variable pay entitlement under the Company C Incentive Programs – HK\$24,550.’

13. In the notification filed by the Employer in respect of the Appellant who was then about to cease to be employed, it was reported that the reason for cessation of employment was ‘resignation’. The particulars of income are as follows:

	HK\$
Salary/wages	676,900
Leave Pay	22,845
Other rewards, allowances or prerequisites – Goodwill ex-gratis / Bonus	<u>193,775¹</u>
Total:	893,520 =====

14. In the tax return filed by the Appellant for the year of assessment 2013/14, he declared that the total employment income derived from the Employer for the period from 1 April 2013 to 31 March 2014 is HK\$716,975.

¹ This includes the Sum.

15. The Assessor raised on the Appellant the Salaries Tax Assessment for the year of assessment 2013/14 based on the information provided by the Employer, that is a total income of HK\$893,520.

16. The Appellant objected to the above assessment but was not successful. The Appellant lodged this appeal.

C. The Relevant Legal Principles

17. Under section 8(1)(a) of the Inland Revenue Ordinance, salaries tax shall be charged for each year of assessment in respect of a person's income arising in or derived from Hong Kong from the source of any office or employment of profit.

18. '*Income from any office or employment*' was defined in section 9(1)(a) of the Inland Revenue Ordinance to include '*any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others*'.

19. The Court of Final Appeal in Fuchs v Commissioner of Inland Revenue [2011] 2 HKC 422 has held that the income chargeable under section 8(1) is not confined to income earned in the course of employment but also embraces payment, viewed as a matter of substance and not merely of form, made 'in return for acting as or being an employee' or 'as a reward for past services or as an inducement to enter into employment and provide future services'.

20. In Fuchs, Ribeiro PJ has reviewed a number of English decisions including Hochstrasser v Mayes [1960] AC 376, Shilton v Wilmshurst [1991] 1 AC 684, Mairs v Haughey [1994] 1 AC 303 and EMI Group Electronics v Coldicott [1999] STC 803 and held that:

'17. ... the same approach should be adopted in the construction of section 8(1) of the Ordinance. Income chargeable under that section 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 section 8(1).

18. It is worth emphasising that a payment which one concludes is "for something else" and thus not assessable, must be a payment which does not come 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, eg, 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".'

21. In determining whether the payment paid to the employee was made as a consideration for abrogating the employee's rights under the contract of employment, Ribeiro PJ, after considering Hunter v Dewhurst (1931) 16 TC 605, Henley v Murray (1950) 31 TC 351, Dale v de Soissons (1950) 32 TC 118, Comptroller-General of Inland Revenue v Knight [1973] AC 428, Mairs v Haughey, *supra*, has further held that:

'22. 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.'

22. The Respondent has also referred this Board to previous Board of Review decisions including D167/98, IRBRD, vol 14, 25, D4/05, (2005-06) IRBRD, vol 20, 256 and D8/13, (2013-14) IRBRD, vol 28, 270.

D. Decision

The Stock Value

23. The Stock Value in the sum of HK\$7,320 was the value of 71 RSU which had been vested and released to the Appellant irrespective of whether these RSU had been sold by the Appellant.

24. The Appellant's challenge against the assessment on the Stock Value was that the same had already been assessed in the previous years of assessment. This is a factual question.

25. The Appellant stated in his grounds of appeal that the sum of HK\$7,320 (i.e. the Stock Value) 'was repeatedly embedded into the HK\$24,255 in the year of 2013/14'. At cross-examination, the Appellant accepted that there is no document to support his contention of embedment. He confirmed that his contention was based on his assumption. There is no proof placed before the Board to illustrate the basis of his assumption or that his assumption is correct.

26. The documents including the Appellant's pay slip support that the Stock Value was not or could not have been included in the Appellant's Salaries Tax Assessment for the previous years.

27. The Appellant bears the burden of proving that the assessment is incorrect or excessive. The Appellant is expected to put forward clear evidence and convincing arguments. It is highly inappropriate and is a waste of public resources for the Appellant to lodge an appeal simply because of his unsupported assumption. The appeal on the assessment of the Stock Value must fail.

The Sum

28. The Sum was described in the Separation Agreement as a 'goodwill ex-gratia payment' made to the Appellant and was part of the sum paid to the Appellant under the Separation Agreement. The Sum was equal to three months' of the Appellant's then basic salary.

29. Applying the operative test laid down in Fuchs, the Sum is in substance derived from the Appellant's employment with the Employer, and is a payment made to the Appellant in return for his acting as or being an employee. The Appellant has not surrendered any pre-existing contractual rights to earn the Sum.

30. The Appellant contended that he signed the Separation Agreement involuntarily. He said that he did not want to quit the job. He contended that due to the conflicts between his two supervisors, he was placed under much pressure and was 'forced' to sign the Separation Agreement. The Appellant also said that he was diagnosed to have tumor in about 2013. He has concerns of his health at that time if he did not sign the Separation Agreement.

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31. In cross-examination, the Appellant has said the following when he was referred to the signing of the Separation Agreement:

‘As I said that signing that kind of agreement was acceptable to me at that time, but I did not want to quit the job.’

‘That would be the best solution. Otherwise, my tumour would burst and then I would die.’

32. The Appellant might have found himself in a weak bargaining position in 2013 with respect to his employment. He himself might have wished that he could continue with the employment. Nonetheless, there is no dispute that he had signed on the Separation Agreement when he was fully aware of its terms. He has also considered that it ‘would be the best solution’ at the time.

33. The Separation Agreement was performed by both parties, including the Appellant.

34. There is no basis at all for the Appellant to argue in this appeal that the Separation Agreement is invalid or ineffective.

35. In 2016, the Appellant had lodged a claim with the Labour Tribunal contending that he was dismissed by the Employer. In the Employer’s Statement of Defence, it was stated that the Appellant resigned. This Labour Tribunal claim was subsequently discontinued by the Appellant. The Appellant contended that the discontinuance was due to his then concern of legal costs.

36. This Board is not to and should not assume any reason for the Appellant’s discontinuance of the Labour Tribunal claim. The fact before this Board remains that there was no adjudication in favour of the Appellant’s allegation of dismissal. The Labour Tribunal claim is of no assistance to the Appellant.

37. In the circumstances, the appeal on the assessment on the Sum is also dismissed.

Sum C

38. In the course of the appeal, the Respondent contended that it discovered that on 4 February 2014, a further 71 RSU were vested and released to the Appellant. The value of these 71 RSU was equivalent to HK\$13,585 (‘Sum C’). The Employer has not reported Sum C as part of the employment income of the Appellant. The Respondent has not included Sum C in the Salaries Tax Assessment for the year of assessment 2013/14 raised on the Appellant.

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39. The Respondent requested this Board to include Sum C in the Appellant's assessable income and accordingly increase the Appellant's Salaries Tax Assessment for the year of assessment 2013/14.

40. The assessment of Sum C was not included in the Appellant's Salaries Tax Assessment and was not a subject matter in the Determination. The Appellant should be given the full right and opportunity to raise objection and appeal as set out in the Inland Revenue Ordinance. The Respondent should not short-circuit the Appellant's rights by only raising the matter in course of this appeal.

E. Disposition

41. By reason of the above, we dismissed the appeal.

42. Pursuant to section 68(9) of the Inland Revenue Ordinance, where the Board does not reduce or annul the assessment appealed against, the Board may order the Appellant to pay as costs of the Board a sum not exceeding HK\$25,000 as specified in Part 1 of Schedule 5 of the Inland Revenue Ordinance, and this amount shall be added to the tax charged and recovered therewith. It is with regret that the Appellant chose to lodge this appeal on the basis of his assumption or speculation without supporting evidence. The Appellant was evasive and refused to answer directly in cross-examination, which in turn unnecessarily prolonged the hearing. The Appellant's conduct in the appeal wasted the Board's resources, we consider that there shall be a costs order against the Appellant pursuant to section 68(9) of the Inland Revenue Ordinance. We therefore order that the Appellant shall pay costs in the sum of HK\$15,000 pursuant to section 68(9) of Inland Revenue Ordinance, which amount shall be added to the tax charged and recovered therewith.