

**Case No. D4/21**

**Salaries tax** – whether a payment received by an employee upon termination of employment is taxable – section 8(1)(a), 9(1)(a), 11B, 11C(a), 11D(b) proviso (ii) and 68(4) of the Inland Revenue Ordinance

Panel: William M F Wong SC (chairman), Fung Chih Shing Firmus and Kwok Yuk Sim Betty.

Date of hearing: 5 October 2020.

Date of decision: 3 May 2021.

This appeal concerns whether a sum of HK\$936,000 (the ‘Sum D’) was from employment and hence taxable.

The appellant submits that Sum D was paid to compensate for the appellant’s early termination of employment. In addition, it is the appellant’s argument that Sum D was paid to her to relieve part of her outstanding mortgage burden.

In supporting her case, the appellant advances her argument in 5 areas: (1) that Sum D was paid for the appellant’s mortgage; (2) that the Sum D was not computed by reference to the appellant’s past performance and was an arbitrary figure; (3) that Sum D was for her compliance of certain post-employment obligations imposed on her under the Separation argument; (4) that Sum D was for the appellant to waive, release and discharge her employer with respect to any claims; and (5) that Sum D was for ‘something else’.

**Held:**

1. Mortgage Payment

The committee considers that the Sum D could not be paid for the appellant’s mortgage payment. First, reading the correspondence between the appellant and the Company, although it was the appellant’s request for the Sum D to be the mortgage repayment, the company’s reason for paying the Sum D was due to the appreciation of the appellant’s work and loyalty to the company. Second, if Sum D was for mortgage repayment, there was no reason why part of the Sum D was for the appellant’s long service payment.

2. Arbitrary Figure

From the email correspondence and the contractual agreement, the Sum D represented the appellant’s 1-year salary instead of an arbitrary figure.

3. Post-employment Obligations

The appellant's argument that the Sum D was for post-employment obligations under the Separation Agreement cannot stand. First, none of the obligations in the Separation Agreement restricted the appellant from taking up another employment. Second, as held in another decision D24/14, the confidentiality and non-disparagement are just basic obligations of any employee, there is no reason Sum D had to be paid for the appellant to comply with these obligations.

4. Waiver and Release of Claim against the Company

Applying the legal test in Fuchs, the onus is on the appellant to prove that one or more of her rights were abrogated in exchange for being paid Sum D by the company. First the committee do not agree there the appellant can have a *bona fide* cause of action under the Employment Ordinance against the company for terminating employment, such that she was given a right to pursue against the company, for which she now claims to waive being given the Sum D. Noting from D24/14, the rights at stake cannot simply be those which the appellant may subjectively think that she had lost, but must be supported by the objective facts and circumstances.

Besides on the available evidence, there is no suggestion that the appellant has given up any contractual claims due to early termination in exchange for Sum D.

5. Something Else

The case Elliott and Poon Cho Ming John relied on by the appellant are distinguishable from the present appeal. The two cases concerned an abrogation and waiver of legal rights whereas in the present appeal, the Sum D was made on top of the contractual and legal obligations. Based on the terms contained in different contractual agreement and the factual matrix of the present case, the committee found that the appellant's previous acting as and being an employee of the company and her services rendered to the company were the effective cause of the payment of Sum D.

The committee also held that the appellant failed to demonstrate to the committee that Sum D was paid 'for something else', for example, in abrogation of her pre-existing contractual rights.

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

Cases referred to:

Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74

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D38/13, (2014-15) IRBRD, vol 29, 189

D24/14, (2015-16) IRBRD, vol 30, 153

Commissioner of Inland Revenue v Elliott, Stewart William George (2007) 1  
HKLRD 297

Commissioner of Inland Revenue v Poon Cho-ming, John (2019) 22 HKCFAR 344

Law Man Pan, Appellant's tax representative, for the Appellant.

Ho Lut Him, Cheng Po Fung and Cheung Ka Yung, for the Commissioner of Inland  
Revenue.

**Decision:**

**The Appeal**

1. In the present appeal, the Appellant, through Mr LAW Man-pan ('the Representative'), submits that a sum of HK\$936,000 (Sum D) was not from employment and hence not taxable.

2. The Appellant submits that Sum D was paid to compensate for the Appellant's early termination of employment. In particular, she faced financial difficulty to repay an outstanding mortgage loan of HK\$1.5 million upon termination of her employment. The Company commiserated with her and Sum D was paid to relieve part of her outstanding mortgage burden.

3. Specifically, the Representative put forth the following submissions:

- (1) Sum D was not paid to the Appellant in return for her acting as or being an employee, as a reward for past services or as an inducement to enter into employment and provide future services.
- (2) Sum D was made 'for something else' and was negotiated between the Appellant and Mr B of the Company based on her outstanding mortgage loan of \$1.5 million. As confirmed in Mr B's email of 29 April 2020, Sum D was paid for the repayment of the Appellant's mortgage only.
- (3) Sum D was not computed by reference to the Appellant's performance or past services but was an arbitrary sum negotiated with Mr B. The Revenue had relied on the Company's confirmation that Sum D was paid due to the Appellant's good services. However, the person making the confirmation did not know the reason directly leading to the payment of Sum D.
- (4) Sum D was not provided for in the employment agreement dated 1 January 2011 ('Employment Agreement 2011') and was thus not a contractual entitlement.

- (5) The Appellant only became entitled to Sum D under the separation agreement dated 30 November 2014 ('the Separation Agreement'). The Appellant did not expect to receive any compensation similar to Sum D.
- (6) Sum D was arisen from certain post-employment obligations imposed on the Appellant under the Separation Agreement. The Appellant, being Position C, had known much sensitive information about the operations of the Company. Confidentiality was of paramount importance to the Company which was reflected in clauses 4 to 6 of the Separation Agreement in relation to 'confidentiality', 'prohibition of slander' and 'non-solicitation'. Clause 10 of the Separation Agreement also empowered the Company to withhold or recover the benefit paid under the agreement, including Sum D, if the Appellant breached her obligations thereunder.
- (7) The dismissal of the Appellant by the Company was not for a valid reason which might violate the Employment Ordinance ('EO'). Under clause 7 of the Separation Agreement, the Appellant waived, released and discharged the Company with respect to any and all claims, actions and causes of action. Therefore, the Appellant had abrogated her right to sue against the Company under the EO and was compensated with Sum D.

### **The Applicable Legal Principles**

4. Sections 8(1)(a), 9(1)(a), 11B, 11C(a), 11D(b) proviso (ii) and 68(4) of the Inland Revenue Ordinance ('IRO') are relevant and applicable to the facts of the present case.

(1) **Section 8(1)(a)**

*'Salaries tax shall, subject to the provisions of [the IRO], 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 ...'*

(2) **Section 9(1)(a)**

*'Income from any office or employment includes—*

*(a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others ...'*

**(3) Section 11B**

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

**(4) Section 11C(a)**

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

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

**(5) Section 11D(b) proviso (ii)**

*‘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 or been deemed to cease to derive income which, if it had been made on the last day of the period during which he derived income, would have been included in that person’s assessable income for the year of assessment in which he ceased or is deemed to cease to derive income from that employment, shall be deemed to have accrued to that person on the last day of that employment.’*

**(6) Section 68(4)**

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

5. The issue of whether a payment received by an employee upon termination of employment is taxable was considered in the Court of Final Appeal case Fuchs v CIR, (2011) 14 HKCFAR 74. Ribeiro PJ at paragraphs 17, 18 and 22 said:

*‘17. ... Income chargeable under [section 8(1) of the IRO] is ... not confined to income earned in the course of employment but embraces payments made ... “in return for acting as or being an employee”, or ... “as a reward for past services or as an inducement to enter into employment and provide future services”...’*

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- ‘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 ... 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”.*’
- ‘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...*’ (Emphasis added.)

6. This Board agrees that if a sum is paid 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, the sum is taxable. While if the sum is made in consideration of the employee agreeing to surrender or forgo his pre-existing contractual rights, but not made pursuant to any entitlement under the employment contract, then the sum is not taxable.

7. In D38/13, (2014-15) IRBRD, vol 29, 189, the taxpayer was requested by his employer to retire early and was paid a lump sum described as ‘gratuity’ upon retirement, which was not provided for in the employment agreement. In deciding the taxability of the sum in question, the Board applied the test adopted in Fuchs.

8. Although the Board agreed that the sum was not paid pursuant to the taxpayer’s employment contract, it was nonetheless held that, as a matter of fact and degree, the sum was paid in return for the taxpayer’s previously acting as an employee for a long

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period, instead of a compensation for abrogation of the taxpayer's right. The following were stated in the decision:

- '30. *On the other hand, was the Gratuity compensation for abrogation of the Appellant's right for loss of his office or employment (or whatever similar nature, irrespective of the labels, which in substance was as such)? The answer must be no, if no right, for which the Appellant could point to under the contract of employment, was abrogated by the request by the employer for his early retirement ...*'
- '31. *Further, there is no evidence that then (in 2011) Appellant bona fide believed that he had a legally enforceable right against his employer for requesting his early retirement and the employer was aware of such belief by the Appellant, and his employer compensated him by the Gratuity because of that bona fide belief by the Appellant.'*
- '33. *In the words of the employer, the Gratuity was paid so as "treating you with the recognition you deserve after more than 38 years with the bank"; i.e. as a gesture of goodwill in reward for his long service of employment to the employer.'*
- '34. *Thus, as a matter of fact and degree, the Gratuity was paid to the Appellant in return for his (previously) acting, for a long period, as an employee. The Gratuity, in substance, was "income from employment."* (Emphasis added.)

9. In D24/14, (2015-16) IRBRD, vol 30, 153, the taxpayer's employment was terminated by his employer and he was paid a sum pursuant to a termination letter which contained confidentiality and non-disparagement clauses. The taxpayer argued that the sum was severance payment in nature and was paid in consideration of his agreement to surrender or forgo all his pre-existing contractual and legal rights. In dismissing the appeal, the Board accepted that the confidentiality and non-disparagement clauses were general terms. They did not impose any additional restriction on the taxpayer and were just basic obligations of any employee. Concerning the issue of abrogation of rights, the Board pointed out that the rights at stake cannot simply be those which the taxpayer may subjectively think that he had lost, but must be ascertained by the objective facts and circumstances including scrutinizing the terms of the employment contract. Taking into account all said and done, the Board decided that objectively the taxpayer's employment with, or his services rendered to his employer was the cause of the payment of the sum in question. The sum was ex-gratia, linked with the taxpayer's performance, but not compensation payment of any sort.

### **Analysis**

10. The Revenue submits that the facts stated in the first part (i.e. Facts upon which the determination was arrived at) of the Determination are relevant to the present appeal.

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11. The Appellant had commented on certain information provided by her former employer, namely Company E ('the Company'). The comments included the circumstances leading to the termination of her employment and the immediate reasons giving rise to the payment of Sum D.

12. The Appellant did not dispute that only part of Sum D was reported to the Revenue after offsetting the long service payment ('LSP') of HK\$105,000 made to her in accordance with the EO, as stated in paragraph (10)(d) of the first part of the Determination. The Revenue accepts that the LSP in the amount of HK\$105,000 was not chargeable to Salaries Tax and in fact, the same was excluded from tax in the assessment in dispute. Therefore, the Revenue submits that the present appeal merely concerns the chargeability of the remaining balance of Sum D, i.e. Sum D HK\$936,000 – LSP HK\$105,000 = HK\$831,000 ('Sum D1').

13. The Board considers that a material consideration about the nature of the payment of Sum D1 is the Company's confirmation with the Revenue where the Company stated that Sum D was paid due to the Appellant's good services. There is no withdrawal of such confirmation as far as the confirmation is concerned.

14. The Appellant submits that the person making the confirmation did not know the reason directly leading to the payment of Sum D. If so, the Appellant could have clarified with the Company and the Company could confirm the correct position with the Revenue. That did not happen.

15. It is correct that in the Appellant's email to Mr B dated 30 October 2014, the Appellant did seek the Company's help to pay off her outstanding mortgage loan of \$1.5 million.

16. However, in his reply dated 1 November 2014, Mr B declined the Appellant's request. Instead, based on his understanding of the local standard and the Appellant's loyal employment with the Company, Mr B offered to pay a sum of HK\$936,000 (i.e. Sum D) to the Appellant, which represented 1 full year's salary.

17. At the final stage of the negotiation on 7 November 2014, Mr B also stated that '... we are giving you very special consideration based on the respect and appreciation we have for you.', and '[w]e very much appreciate all your work ...'. No reference was made to the mortgage loan in the other emails exchanged in November 2014.

18. Hence, it is clear that whilst it is correct that the Appellant requested due to a need to pay off her mortgage. The Company's reason for paying her Sum D was due to appreciation of her work and loyalty to the Company. The Company's confirmation with the Revenue is accurate.

19. This is corroborated by the terms of the Separation Agreement. Clause 1 of the Separation Agreement describes Sum D as part of the compensation for the Appellant's



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services to the Company. Clause 1.2 of the Separation Agreement specifically stated that Sum D was paid to the Appellant as a 'retirement benefit', but nothing else.

20. The Board also agrees with the Revenue's submissions that if Sum D was indeed paid to the Appellant for the sole purpose of repayment of mortgage loan, it is unreasonable that part of Sum D was actually the LSP payable to her pursuant to the EO, and Sum D was computed by reference to the Appellant's monthly salary without reference to the mortgage loan owed by the Appellant.

21. As to the submission that Sum D was an arbitrary figure, the Board agrees that Sum D represented the Appellant's 1-year salary. There are also no inconsistencies between the email correspondence exchanged during the negotiation and the terms of the Separation Agreement.

22. Secondly, in respect of the Appellant's submission that Sum D was for certain post-employment obligations imposed on her under the Separation Agreement. We disagree. First, none of the obligations therein restricted the Appellant from taking up another employment.

23. Crucially, by the Employment Agreement 2011 made, the Appellant had already agreed to be bound by the confidentiality provision stated therein. In the Appellant's emails, she also assured Mr B that her professionalism obliged her to uphold confidentiality, which was reiterated by her on 4 November 2014. There is no dispute that the Appellant was well aware of her obligation in relation to confidentiality. In D24/14, the Board accepted that confidentiality and non-disparagement are just basic obligations of any employee. There was no valid reason why Sum D had to be paid for the Appellant's compliance with such obligations which were already part of the Appellant's contractual obligations under the Employment Agreement 2011.

24. The Revenue also correctly reminded the Board that throughout the negotiation between the Appellant and Mr B, all these obligations were not the subject matters discussed or the basis on which Sum D was arrived at.

25. The Appellant also submitted that the Company was empowered to withhold or recover the payments made if the Appellant breached her obligations under the Separation Agreement.

26. Nonetheless, the Board notes that the payment of HK\$364,056 provided in clause 1.1 of the Separation Agreement was actually the Appellant's prorated bonus, outstanding annual leave and payment in lieu of notice, which should have nothing to do with the Appellant's obligations under the Separation Agreement or as otherwise imposed by law.

27. In addition, clause 10 of the Separation Agreement stated that the Company should be entitled to obtain all other relief provided by law. It appears that clause 10 of the Separation Agreement was no more than a standard term in typical termination agreements.

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28. The Board looks at the substance rather than form. On the facts, the Board accepts the Revenue's submission that the obligations under clauses 4 to 6 of the Separation Agreement were those that the Appellant would agree anyway or had to observe under contract or common law. They were not the effective cause of the payment of Sum D.

29. It is also the Appellant's case that she had abrogated her right to initiate an action under the EO against the Company on the ground that she was not dismissed for any valid reason specified by the EO. Sum D was thus a compensation for her abrogation of right.

30. However, the Board bears in mind that the legal test in Fuchs remains the operative test even in cases of 'abrogation of right'. The onus is on the Appellant to prove that one or more of her rights were abrogated in exchange for being paid Sum D by the Company. Also, the Appellant must convince the Board that Sum D was not made in return for her acting as or being an employee, or as a reward for past services.

31. It is important to note that the Employment Agreement 2011 was not on fixed term and can be terminated by giving notice or payment in lieu by either party. In accordance with the Employment Agreement 2011, the Company terminated the Appellant's employment by 1-month notice and gave her 2-month payment in lieu. The Company also made LSP to the Appellant pursuant to the statutory requirement of the EO. In other words, the Appellant should have received all of her contractual and statutory entitlements upon her dismissal.

32. On the evidence, it is hard to see how the Appellant can have a *bona fide* cause of action under the EO against the Company for terminating her employment and the Company was aware of such potential claim, for which Sum D was allegedly paid. The Board agrees that this resembles the situation in D38/13 which formed part of the Board's reasoning in dismissing that appeal.

33. As pointed out by the Board in D24/14, the rights at stake cannot simply be those which the Appellant may subjectively think that she had lost, but must be supported by the objective facts and circumstances.

34. It is true that there is a waiver and release of claims clause in the Separation Agreement (Clause 7) under which the Appellant waived and/or released her claims against the Company. But the fact is that at the material time, as a matter of fact, the Appellant did not have any viable claims against the Company. As said above, the Board looks at the substance and not the form. We agree with the Revenue that since the Appellant could not identify precisely what specific right she had abrogated and Sum D was paid to her for giving up that right, such release clauses render no assistance to her case.

35. To conclude, on the evidence before this Board, we conclude that there is no evidence that the Appellant has given up any contractual claims due to early termination in exchange for Sum D.

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36. Furthermore, it does not matter that Sum D was not a contractual entitlement under the Employment Agreement 2011. Income chargeable to Salaries Tax is not confined to income earned in the course of employment. In D38/13, the taxpayer was not entitled to the gratuity pursuant to the employment agreement, but this did not prevent the Board from concluding that the gratuity was paid in return for acting as an employee. This Board is of the view that the sum under appeal is in essence a gratuity for the Appellant's loyalty and good services during her employment with the Company. The fact that the Appellant might not have expected this gratuity is irrelevant.

37. Finally, the Representative also relied on the cases of Elliott and Poon Cho Ming John. However, on the facts of both cases that the sums were paid 'for something else'. In Elliott, the sum was paid for abrogation of all the taxpayer's rights in relation to certain 'Incentive Compensation Plan' units. In Poon Cho Ming John, the taxpayer had issued serious legal threats against the employer: to start court proceedings and to challenge his removal at a general meeting of the employer's shareholders. The sums were paid by the employer so that the taxpayer would give up those threats and go away quietly.

38. In the present case, Sum D1 was paid by the Company to the Appellant on top of its contractual and legal obligations. Mr B mentioned in his emails to the Appellant that Sum D (including Sum D1) was made based on very special consideration, respect and appreciation in view of the Appellant's loyal employment and her past services. If the Appellant's performance had not been satisfactory, or she did not deserve the Company's special consideration, respect and appreciation, Sum D1 would unlikely have been paid. The Separation Agreement also referred to Sum D as 'retirement benefit' which was part of the compensation for the Appellant's services to the Company.

39. The Board agrees with the Revenue that the Appellant's previously acting as and being an employee of the Company, and her services rendered to the Company, were the effective causes of the payment of Sum D1. It was an income from employment in gratuitous nature and chargeable to Salaries Tax. Also, the Appellant failed to demonstrate to the Board that Sum D1 was paid 'for something else', for example, in abrogation of her pre-existing contractual rights.

40. The fact that the Company reported Sum D1 in the notification by an employer of an employee who is about to cease to be employed further showed that the Company regarded Sum D1 as part of the Appellant's remuneration.

41. Even though the Appellant received HK\$468,000 of Sum D1 only in April 2015, this part of Sum D1 is deemed to have accrued to her on the last day of her employment with the Company, i.e. 30 November 2014 by reason of sections 11B, 11C and 11D(b) proviso (ii) of the IRO. Accordingly, Sum D1 was chargeable to Salaries Tax for the year of assessment 2014/15.

### **Disposition**

42. For all the reasons stated above, the present appeal is dismissed.

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43. The Appellant is ordered to pay a sum of HK\$10,000 as costs to the Revenue.