Case No. D7/18

Salaries tax – sums received prior to commencement of employment – points raised after conclusion of appeal – section 8(1), 11B, 11C, 11D(b), 12(e) and 66(1) of the Inland Revenue Ordinance

Panel: Anson Wong SC (chairman), Chan Pik Kiu Michael and Catrina Ding Wan Lam.

Date of hearing: 1 February 2018.
Date of decision: 27 June 2018.

A firm of solicitors (the 'Firm') offered to employ the taxpayer on condition that she would complete Course A prior to her commencement of work in August 2012. Pursuant to the offer, the Firm reimbursed the taxpayer the cost of her Course A fees and paid her a maintenance allowance (the 'Sums') in February 2012 which would have been repayable to the Firm upon request had she not commenced employment with the Firm as agreed in Aug 2012. The assessor raised on the taxpayer an Additional Salaries Tax Assessment for the year of assessment 2102/13 to bring the Sums into assessment. The taxpayer objected on the grounds that the Sums were not paid to her within the year of assessment 2012/13 and the Firm's right to request for repayment should not affect her entitlement to claim payment. She argued that section 8(1) of the IRO includes payment made 'as an inducement to enter into employment and provide future services' and section 11B has the clear effect that assessable income in each year of assessment is all the income accrued to the taxpayer in that particular year of assessment. The primary argument of the CIR was that the Sums only became taxable when the taxpayer ceased to have any liability to repay the Sums. Alternatively, section 11C had the effect of deeming the date of accrual to be the date of the commencement of her employment. After the hearing, the taxpayer wrote to the Board requesting the latter to consider that in the event that the Sums were held to be taxable in the year of assessment of 2012/13, the taxpayer would make an application for the deduction for expenses of self-education pursuant to section 12(e) of the IRO in respect of the full amount of Course A fees, a new point not raised in the appeal.

Held:

1. The Board had to look at the substance of the transaction and ask the question as to when a taxable income came into existence. The offer made by the Firm was 'conditional upon' the taxpayer completing her Course A. Thus there would not be any binding employment relationship until and unless the taxpayer successfully completed her Course A. Viewed in this light, it was artificial, and indeed wrong in principle, to characterise the Sums which were received by the taxpayer before the completion of her

Course A as a taxable income at the time of receipt since there was not even binging employment offer at such point in time. The correct analysis was that the Sums only became taxable income as and when the taxpayer joined the Firm and the Firm lost or waived its right to claim back the same in August 2012.

2. Given the above ruling, it would not be necessary for the Board to deal with the alternative argument raised by the CIR. Hence, it was dealt with briefly. The Board considered that sections 11B and 11C of the IRO concern the issue of timing of the assessment, but not the issue of chargeability. For the present purpose, the Board could not see why it should ignore the clear literal meaning of section 11C which deems the taxpayer to have received her taxable income at the point in time when she started her employment with the Firm.

3. In light of section 66(1) of the IRO, it appeared that the jurisdiction of the Board to entertain new point not contained in a notice of appeal is only exercisable at the hearing of the appeal. Thus, it considered that it has no jurisdiction to entertain the new point which was only raised after the hearing of the appeal. Even assuming the Board had jurisdiction to entertain new point after the conclusion of the appeal, it would exercise its discretion against the taxpayer. The new point was not raised by her before the CIR when she objected to the Additional Salaries Tax Assessment for the year of assessment 2012/13. Thus the issue and the evidence relevant to such issue had never been presented and canvassed before the CIR, let alone before the Board in the present appeal.

Appeal dismissed.

Cases referred to:

B/R 13/74, IRBRD, vol 1, 159
D77/89, IRBRD, vol 6, 177
Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74
Clayton v Gothorp (1971) 47 TC 168
D83/00, IRBRD, vol 15, 726
D119/02, IRBRD, vol 18, 113
D55/12, (2013-14) IRBRD, vol 28, 113
Commissioner of Inland Revenue v Sawhney [2006] 3 HKLRD 21

Appellant in person.
Julian Lam, Counsel, instructed by Department of Justice, for the Commissioner of Inland Revenue.

Decision:

The Appeal

1. This is the appeal by the taxpayer (the 'Taxpayer') from the determination dated 27 September 2017 (the 'Determination') of the Deputy Commissioner of Inland Revenue (the 'CIR') in respect of the Taxpayers' Salaries Tax Assessment for the year of assessment 2012/13.

2. The dispute between the Taxpayer and the CIR is whether certain sums received by the Taxpayer from her employer prior to the commencement of employment should be assessed in the year of assessment when she actually received those sums (as so contended by the Taxpayer), or whether they should be assessed in the year of assessment during which her employment started (as so determined by the CIR).

The Factual Background

3. At the hearing, the Taxpayer confirmed to us that the facts set out in paragraphs 1(1) to 1(9) of the Determination are not in dispute. Hence, the appeal will be dealt with on the basis of such undisputed facts, which are set out as follows:

(1) The Taxpayer had objected to the Additional Salaries Tax Assessment for the year of assessment 2012/13 raised on her. The Taxpayer claims that certain sums she received from her employer prior to commencement of employment should be assessed in the year of assessment when she actually received the sums.

(2) By a letter dated 20 July 2010 (the 'Offer Letter'), a firm of solicitors (the 'Firm') offered to employ the Taxpayer as trainee solicitor on condition that she would complete Course A commencing in 2011 in Hong Kong. According to the Offer Letter, the terms of the Taxpayer's employment with the Firm included the following:

(a) The Taxpayer was expected to start work in August 2012.

(b) The Firm would reimburse the Taxpayer the cost of her full-time Course A fees at, among others, University B up to the UGC standard amount. Reimbursement would only be made on the production of a valid, original receipt from the University (the 'University Receipt').

(c) The Firm would pay the Taxpayer a maintenance allowance of \$50,000 while she was studying full-time Course A. The amount would be paid to the Taxpayer by two installments at the same time when she was reimbursed Course A fees.

(d) If for whatever reason the Taxpayer did not join the Firm as planned in August 2012, she should on request repay to the Firm any money previously paid to her in reimbursement of Course A fees and in maintenance allowance within 28 days.

The Taxpayer signed to confirm her acceptance of the Firm's offer on 22 July 2010.

(3) On 6 September 2012, the Taxpayer entered into a trainee solicitor contract (the 'Contract') with a solicitor and a partner of the Firm. According to the Contract, the Taxpayer commenced employment with the Firm on 27 August 2012 and would be employed from that date for a period of 24 months.

(4) The Firm filed an Employer's Return of Remuneration and Pensions (the 'Employer's Return') in respect of the Taxpayer for the year from 1 April 2012 to 31 March 2013 showing, inter alia, the following particulars:

(a) Capacity in which employed: Trainee Solicitor

(b) Period of employment: 27 August 2012 – 31 March 2013

(c) Income accrued – salary/wages: $307,935

(5) In her Tax Return – Individuals for the year of assessment 2012/13, the Taxpayer reported that she derived salaries income of $307,935 from her employment with the Firm as a trainee solicitor during the period from 27 August 2012 to 31 March 2013.

(6) Based on the tax returns filed, the Assessor raised on the Taxpayer the following Salaries Tax Assessment for the year of assessment 2012/13:

	$
Income [Facts (4)(c) & (5)]	307,935
Less: Basic allowance	(120,000)
Net Chargeable Income	187,935
Tax Payable thereon (after tax reduction)	9,948

The Taxpayer did not object to the above assessment, which had become final and conclusive in terms of section 70 of the Inland Revenue Ordinance ('IRO').

(7) In response to the Assessor's enquiries, the Firm provided the

following information in respect of the payments it made to the Taxpayer:

(a) The Firm paid maintenance allowance and reimbursed Course A fees to the Taxpayer on the below dates:

Date of payment	Maintenance allowance	Reimbursement of Course A fees
	$	$
26 October 2011	25,000	21,500
14 February 2012	25,000	21,050
Total	50,000	42,550
	('Sum A')	('Sum B')

(b) The Taxpayer was required to provide confirmation or the University Receipt of her Course A fees payment upon request for reimbursement.

(c) Copies of email correspondences between the Taxpayer and the Firm showing that the Taxpayer submitted the University Receipt to the Firm in October 2011 and 13 February 2012 for reimbursement of Course A fees and payment of maintenance allowance.

(d) The Taxpayer's obligation for repayment of Sum A and Sum B (collectively, the 'Sums') was released when she joined the Firm on 27 August 2012.

(8) The Assessor considered that the Sums should be chargeable to Salaries Tax. He raised on the Taxpayer an Additional Salaries Tax Assessment for the year of assessment 2012/13 to bring the Sums into assessment as follows:

Income already assessed [Fact (6)])	307,935
Add: Sum A [7(a)]	50,000
Sum B [7(a)]	42,550
Assessable Income	400,485
Less: Basic allowance	(120,000)
Net Chargeable Income	280,485
Less: Net Chargeable Income already assessed [Fact (6)]	(187,935)
Additional Net Chargeable Income	92,550
Tax Payable thereon (after tax reduction)	25,682
Less: Tax already charged	(9,948)
Additional amount of Tax Payable thereon	15,734

(9) The Taxpayer objected to the Additional Salaries Tax Assessment in

Fact (8) on the following grounds:

(a) The Sums were not paid by the Firm to the Taxpayer within the year of assessment 2012/13. Pursuant to sections 8 and 11B of the IRO, the Sums should be taxed in the year of assessment 2011/12 in which the Sums were made to the Taxpayer.

(b) She was contractually entitled to claim payment of the Sums when she submitted the University Receipt to the Firm in October 2011 and February 2012. The Firm's right to request for repayment in case the Taxpayer failed to join the Firm should not affect her entitlement to claim payment. By applying sections 11B and 11D(b) of the IRO, the Sums should be taxed in 2011/12. The Taxpayer referred to the Board of Review Decisions B/R 13/74, IRBRD, vol 1, 159 and D77/89, IRBRD, vol 6, 177 to support her claim.

4. The CIR rejected the Taxpayer's objection and held that the Salaries Tax is chargeable in respect of the Sums for the year of assessment 2012/13, during which the Taxpayer commenced her employment with the Firm.

Taxpayer's Arguments

5. In this case, there is no dispute between the parties that the Sums were taxable income. The only issue in dispute is *when* they should be assessed.

6. The Taxpayer began by referring to section 8(1) of the IRO, which provides that:

> '*Salaries tax shall, subject to the provisions of this Ordinance, be charged* ***for each year of assessment*** *on every person in respect of his income arising in or derived from Hong Kong from the following sources –*
>
> *(a)* ***any office or employment of profit****; and*
>
> *(b)* *any pension*' (emphasis added by the Taxpayer)

7. The Taxpayer then referred to the decision of the Court of Final Appeal in Fuchs v CIR (2011) 14 HKCFAR 74 and submitted that, since income chargeable under section 8(1) of the IRO includes payments made '*as an inducement to enter into employment and provide future services*', the Sums therefore were chargeable even before the commencement of employment.

8. The Taxpayer further relied upon section 11B of the IRO, which provides 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****.*' (emphasis added by the Taxpayer)

9. The Taxpayer submitted that the clear effect of section 11B of the IRO is that assessable income in each year of assessment is all the income accrued to the taxpayer in *that particular* year of assessment. She, therefore, argued that the Sums should be assessed at the time of actual receipt.

CIR's Arguments

10. The primary argument of the CIR is that the Sums only became taxable income when the Taxpayer joined the Firm and ceased to have any liability to repay the same. Accordingly, the Sums should be assessed in the year of assessment 2012/13 during which the Taxpayer commenced her employment with the Firm.

11. Alternatively, the CIR contends that even if the Sums were taxable income before the commencement of her employment with the Firm, section 11C of the IRO has the effect of deeming the date of accrual of the Sums to be the date of the commencement of her employment. In this regard, section 11C provides that:

> '*For the purpose of section 11B, a person shall be deemed to commence or cease, as the case may be, to derive income from a source whenever and as often as he commences or ceases* -
>
> *(a) to hold any office or employment of profit; or*
>
> *(b) to become entitled to a pension.*'

Discussion

12. In view of the arguments advanced by the parties, the first issue which we need to decide is the proper characterization of the Sums received by the Taxpayer from the Firm before the commencement of her employment with the Firm. This in turn requires us to consider the terms of the Offer Letter, pursuant to which the Sums were paid to the Taxpayer.

13. The Offer Letter contained, amongst others, the following express terms:

> (1) <u>Clause 1</u>: 'This offer is conditional upon [the Taxpayer] completing [Course A] commencing in 2011 in Hong Kong. If [the Taxpayer] [is] unsuccessful in the course, [the Firm] reserves the right to review [the Taxpayer's] employment with [the Firm]…'

(2) Clause 9: '[The Firm] will reimburse the costs of full-time [Course A] fees … Reimbursement will only be made on the production of a valid, original receipt from the University … If for whatever reason [the Taxpayer] [does] not join [the Firm] as planned in late August 2012, [the Taxpayer] must, on request, repay to the firm any money previously paid to [the Taxpayer] in reimbursement of pre-[Course A] related costs and [Course A] fee within 28 days.'

(3) Clause 10: 'Whilst [the Taxpayer] [is] studying [Course A] full-time [the Taxpayer] will be paid a maintenance allowance of HK$50,000. This will be paid to [the Taxpayer] in two instalments at the same time as [the Taxpayer] [is] reimbursed [Course A] fees. If for whatever reason [the Taxpayer] [does] not join [the Firm] as planned in late August 2012, [the Taxpayer] must, on request, repay to the firm any money previously paid to [the Taxpayer] in maintenance allowance within 28 days'.

14. There is no dispute that the Sums received by the Taxpayer represented the Firm's payments of the Taxpayer's Course A costs and maintenance allowances under the Offer Letter.

15. Mr Julian Lam, Counsel for the CIR, submitted that under the Offer Letter, the Taxpayer had the liability to repay the Sums in the event that she for whatever reasons did not join the Firm. Hence, one cannot say that the Taxpayer received the Sums absolutely and unconditionally. It was only upon the Taxpayer joining the Firm that the Taxpayer would be discharged of her obligation to repay, and that the Sums would become an 'absolute payment' and a taxable income.

16. In support of his argument, Mr Lam referred to a number of educational loan cases (e.g. Clayton v Gothorp (1971) 47 TC 168, D83/00, IRBRD, vol 15, 726, D119/02, IRBRD, vol 18, 113) in which the court or tribunal in question held an educational loan would only become the employee's income at the point when the employer waived his right to recover the same from the employee.

17. The Taxpayer disagreed with Mr Lam's submission. She sought to distinguish her case from the said educational loan cases by contending that the Sums paid by the Firm in this case were not 'loans'; rather, they were absolute payments with an obligation to repay, which only arose when she did not join the Firm and the Firm requested her to repay.

18. In response to the Taxpayer's argument, Mr Lam submitted that the distinction drawn by the Taxpayer is invalid. He submitted that the so-called distinction between a loan which would be waived upon certain events, and an allowance would be repayable upon certain events, is a distinction without difference. According to Mr Lam, we should look at the substance, rather than label, in deciding when a taxable income came into existence.

19. On this point, Mr Lam drew our attention to the decision of this Board (chaired by Mr Huen Wong) in D55/12, (2013-14) IRBRD, vol 28, 113. In that case, this Board was called upon to decide whether subsidies received by a taxpayer from his employer for his enrollment in a MBA course were taxable. There, the subsidies were given to the taxpayer on the basis that he agreed not to leave employment within one year of completion of his course, or that the employer would have the right to seek a refund of the subsidies. In its decision, this Board held that such subsidies were taxable income and more pertinently, that it was the time the taxpayer's employer losing the right to claim back the subsidies, but not the date when they were paid, which determined the year of assessment of which they should be treated as income (at paragraphs 6(8) to 6(18) thereof).

20. We agree with Mr Lam's submission. The distinction sought to be drawn by the Taxpayer is, in our view, barren. It does not matter whether the Sums received by the Taxpayer were described as 'loans' or 'payments with a conditional obligation to repay'. At the end of the day, we have to look at the substance of the transaction and ask the question as to when a taxable income came into existence.

21. In this regard, we observe that pursuant to Clause 1 of the Offer Letter, the offer made by the Firm was 'conditional upon' the Taxpayer completing her Course A. Thus, there would not be any binding employment relationship until and unless the Taxpayer successfully completed her Course A. Viewed in this light, it is artificial, and indeed wrong in principle, for us to characterize the Sums, which were received by the Taxpayer *before* the completion of her Course A, as a taxable income *at the time of receipt* since there was not even binding employment offer at such point in time.

22. In our view, the correct analysis is that the Sums only became taxable income as and when the Taxpayer joined the Firm and the Firm lost or waived its right to claim back the same in August 2012. For this reason alone, the CIR is plainly right to hold that the Sums should be assessed in the year of assessment of 2012/13, and the Taxpayer's appeal must fail.

23. Given our ruling in the foregoing paragraph, strictly speaking, it would not be necessary for us to deal with the alternative argument raised by the CIR, namely that section 11C of the IRO has the effect of deeming the date of accrual of the Sums to be the date of commencement of employment. Hence, we will be brief in dealing with this alternative argument.

24. At the hearing of the appeal, the Taxpayer fairly conceded that if section 11C of the IRO is to be read literally, it will have the effect contended for by the CIR, i.e. the Taxpayer would be deemed to derive income at the point in time when she started her employment with the Firm.

25. The Taxpayer invited this Board not to read the section literally by referring us to the decision of Deputy Judge Muttrie in CIR v Sawhney [2006] 3 HKLRD 21. We do not consider that the decision to be of any assistance for the present purpose. The issue in the Sawhney case was whether the taxpayer was liable or not liable to pay

salaries tax in respect of benefits received after the cessation of employment. It is not a decision concerning *when* a taxable income should be assessed. In our view, whatever observations made by Deputy Judge Muttrie in the Sawhney case must be read and understood in their proper context.

26. The Taxpayer further submitted that the literal application of section 11C would lead to absurd scenario. For example, she submitted that if section 11C is to be applied literally, it may result in a situation where a prospective employee, who received advanced payment from an employer to induce him to become an employee, would not be required to pay tax in respect of such advanced payment if he eventually did not start employment at all.

27. We do not think the example cited by the Taxpayer is helpful. In the said scenario referred to by the Taxpayer, it only meant that the deeming provision *as to timing* in section 11C cannot come into operation as a result of there being no commencement of employment. However, it does not necessarily follow that the prospective employee receiving the advanced payment can keep it tax-free. At the end of the day, sections 11B and 11C of the IRO concern the issue of timing of assessment, but not the issue of chargeability.

28. For the present purposes, we cannot see why we should ignore the clear literal meaning of section 11C of the IRO, which deems the Taxpayer to have received her taxable income at the point in time when she started her employment with the Firm.

29. For the above reasons, we dismiss the Taxpayer's appeal and confirm the assessment raised on the Taxpayer.

Postscript

30. After the hearing of the appeal, we received a letter dated 12 February 2018 inviting us to consider a new point not raised in the appeal. The new point is that in the event that the Sums are held to be taxable in the year of assessment of 2012/13, the Taxpayer would make an application for the deduction for expenses of self-education pursuant to section 12(e) of the IRO in respect of the full amount of Course A fees, i.e. HK$42,550.

31. In response, the Department of Justice (on behalf of the CIR) issued a letter dated 14 February 2018 stating that this Board should not entertain the new point raised by the Taxpayer. In that letter, the CIR emphasized that the burden was rested on the Taxpayer to raise all her points at the appeal (including obtaining leave to raise any other matters outside the original grounds of appeal) and that any argument on the new point had to be supported by proper evidence. The CIR also made the observation that bearing in mind that Course A fees were paid in the year of assessment of 2011/12, but not in the year of assessment of 2012/13, their deduction would not be allowed when ascertaining the assessable income in the year of assessment of 2012/13.

32. Later on, we received a further letter dated 23 February 2018 from the

Taxpayer responding to the said letter from the Department of Justice. Essentially, the Taxpayer accepted that it is for this Board to decide whether or not to accept the new point raised by her, but she submitted that in the interest of saving costs and time, it would be more appropriate and cost-effective for the new point of deduction to be dealt with in the present appeal.

33. Section 66(1) of the IRO provides that '*any person … who has validly objected to an assessment but with whom the Commissioner in considering the objection has failed to agree* may within 1 month file a notice of appeal together with, amongst others, a statement of grounds of appeal. Section 66(3) of the IRO further provides that:

> '*Save with the consent of the Board and on such terms as the Board may determine,* ***an appellant may not <u>at the hearing of his appeal</u> rely on any grounds of appeal other than the grounds contained in his statement of grounds of appeal*** *given in accordance with subsection (1).*' (emphasis added)

34. In light of the above provisions, it appears that the jurisdiction of this Board to entertain new point not contained in a notice of appeal is only exercisable at the hearing of the appeal. In the present case, the hearing of the appeal was concluded on 1 February 2018. Thus, we consider that we have no jurisdiction to entertain the new point which was only raised by the Taxpayer after the hearing of the appeal.

35. Even assuming we have jurisdiction to entertain the new point after the conclusion of the appeal hearing, we would exercise our discretion against the Taxpayer. The new point raised by her was not raised by her before the CIR when she objected to the Additional Salaries Tax Assessment for the year of assessment 2012/13. Thus, the issue and the evidence relevant to such issue have never been presented and canvassed before the CIR, let alone before this Board in the present appeal. We do not think there is any valid justification for this Board to consider the new point after the conclusion of the appeal hearing.