Case No. BR 15/77

Board of Review:

Chan Ying-hung, *Chairman*, R. Beynon, Kenneth T. C. Lo and D. V. Timmis, M*embers*.

30th August 1978.

Salaries tax – government employee in receipt of education allowance for children – whether allowance assessable to salaries tax – Inland Revenue Ordinance, section 8(2)*(g)* and 9.

The taxpayer was an overseas officer in the service of the Hong Kong Government. No service contract was signed between the Government and the taxpayer. Under the Civil Service Regulations which applied to the taxpayer, the taxpayer was eligible to claim education allowance for his two children who were being educated in the United Kingdom. In the year of assessment 1975/76 the taxpayer claimed and was paid $16,791.00 as overseas education allowance for his children, which sum was included in his income on which salaries tax was assessed. The taxpayer objected to the assessment on the grounds that the allowance received was exempt from salaries tax under section 8(2)(g) of the Inland Revenue Ordinance, that it was paid as part of a separate and collateral agreement unrelated to the services rendered by him to his employer, and that any allowance paid to a member on behalf of another of the same family unit should be excluded as income under section 8(2)(g).

On appeal.

Decision: Appeal disallowed. Assessment confirmed.

Taxpayer in person.
Benjamin Shih for the Commissioner of Inland Revenue.

Cases referred to:-

1. Hochstrasser v. Mayers, (1959) 3 All E.R. 817.
2. Laidler v. Perry, (1965) 2 All E.R. 121.
3. Pritchard (H.M. Inspector of Taxes) v. Arundale, 47 T.C. 680.
4. C.I.R. v. Humphrey, H.K.T.C. 451.

Reasons :

1. The Taxpayer is an Overseas Officer in the service of the Hong Kong Government. In the year of assessment 1975/76 he received from the Hong Kong Government $16,791.00 being Overseas Education Allowance, which we shall refer to as "O.E.A." and the issue in this appeal is whether the sum received by him is assessable to Salaries Tax. During this period he had two children who were educated at approved schools in the United Kingdom.

2. It is common ground that no service contract was signed between Government and the Taxpayer and that the terms of his employment are to be found in certain regulations and circulars made by Government from time to time. These regulations formerly known as Establishment Regulations are now called Civil Service Regulations ("C.S. Regulations"). These Regulations apply to all Government Servants. O.E.A. was first introduced in 1964 by certain circulars which have since been incorporated in the C.S. Regulations. Such of them as are material to this appeal are set out below:-

755. *Eligibility to claim education allowances*

(1) Officers (including widows) on probation or confirmed to the permanent and pensionable establishment, or on agreement or on temporary transfer from the British Civil Service or other administrations are eligible to claim education allowances, which are taxable.

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756. *Children for whom an allowance may be claimed*

Allowances may be claimed for the son or daughter of an eligible officer, including a step-son, step-daughter, lawfully adopted son or lawfully adopted daughter, being unmarried and wholly dependent upon the officer.

757. *Period of claim*

(1) An officer joining the service may claim Overseas Education Allowance from the beginning of the school term next after the date of his appointment …

(2) An officer retiring, resigning, being invalided from the service, or leaving the service on completion of agreement or on transfer to other public service, and an officer commencing no pay leave (except no pay sick leave, during which an officer's eligibility for education allowances is not affected) may claim Overseas Education Allowance up to the end of the term, and Local Education Allowance up to the end of the accounting period which begins prior to the date of his leaving the service, or commencing no pay leave, provided that:

(a) the child or children remain at the school for which allowances have been approved; and

(b) ……

(3) ……

(4) An officer who resigns from the service without giving due notice, or whose service has been terminated by the Government, will cease to be eligible for education allowances with effect from the day he leaves the service, or the date on which his services are terminated, and the officer may be required to refund an allowance that has been overpaid.

Other regulations, details of which we need not go into, prescribe that an officer must complete an initial application form and that allowances are payable to him on a reimbursement basis.

3. During the year of assessment 1975/76 the Taxpayer was assessed to Salaries Tax in the sum of $15,014.00 on a net chargeable income of $75,049.00 which includes O.E.A. of $16,791.00 received by him from Government. When the Taxpayer first objected to the assessment, his ground was that the sum of $16,791.00 was exempt from Salaries Tax under section 8(2)(g) of the Inland Revenue Ordinance as being an "amount arising from a scholarship, exhibition, bursary, or other similar educational endowment". His objection was rejected by the Commissioner on the ground that the exemption under section 8(2)(g) extends only to any scholarship etc. "held by a person receiving full time instruction at an education established" and as the Taxpayer who received the allowance was not such a person the provisions of section 8(2)(g) do not apply to his case.

4. The Taxpayer appealed against this. His grounds, as amended, may be stated as follows. First the allowance paid to him by his employer does not arise from his employment since it is not paid to him as remuneration for services rendered by him under his service agreement; rather it is paid as part of a separate and collateral agreement which has nothing to do with services rendered by him to his employer. Secondly, the allowance is a "similar educational endowment" within the meaning of section 8(2)(g); it is paid to him on behalf of and in trust for the persons beneficially entitled thereto, namely his children. Additionally, as he is taxed as a family unit, any allowance to one member of the family on behalf of another of the same family unit should be exempt under section 8(2)(g).

5. At the hearing the Taxpayer offered himself for cross-examination after his opening address. His evidence is to the effect that when he first joined Government, he did not sign any contract; his service agreement consists of regulations and circulars published by Government from time to time; the regulations were drawn to his attention and it was his duty to know such regulations; the nature of the collateral agreement he relied on is that if he educated his children abroad, Government would pay part of the expenses incurred; the agreement is one which redounds to the mutual benefit of Government and officers in the

Police Force; and he accepts that what Government offered him is a package deal that includes a number of allowances for different purposes, among them being O.E.A. since 1964.

6. Other facts which the Revenue does not challenge are that O.E.A. is payable only to officers who have opted for new leave terms and the Taxpayer is one of them. Moreover, financially speaking, Government would benefit from Taxpayer's children being educated in England than at King George V School in Hong Kong. The school fees are paid by the Taxpayer first and then re-imbursed by Government.

7. In support of his first ground, the Taxpayer cited the case of **Hochstrasser v. Mayers**[1]**.** That was a case in which the taxpayer was employed by the Imperial Chemical Industries under a service contract dated 27th April 1951 which provided that the employers should be at liberty to change the locality of the taxpayer's employment in which event he would be paid such removal and her expenses as the employers should consider fair and reasonable. Such service agreement was terminable by either party by 3 months' notice. The I.C.I, also had a scheme for assisting their married employees to purchase houses. The employee availed himself of such a scheme and purchased a house pursuant to a housing agreement dated 1st June 1951 which contained provisions for interest free loans and for guaranteeing the employee against loss on resale. The House of Lords upheld the judgments of Upjohn J. (as he then was) and the Court of Appeal that the compensation received by the Taxpayer was something which was wholly collateral and really had nothing to do with the office or with the services which the employee was bound to render to his employers. The Taxpayer quoted extensively from the judgment of Upjohn J. and the speech of Lord Radcliffe in support of the proposition that it is not sufficient to render a payment assessable to income tax by merely establishing that the person who received it would not have received it if he had not been an employee. He also relied on the following passages from Lord Cohen's speech at p. 825:-

> "My Lords, on the facts of the present case, I am satisfied that Jenkins L.J. was right, when he said 'It may well be said here, I think, that while the taxpayer's employment by (I.C.I.) was a *causa sine qua non* of his entering into the housing agreement and consequently in the events which happened requiring a payment from (I.C.I.) the *Causa causan* was the distinct contractual relation subsisting between (I.C.I.) and the taxpayer under the housing agreement, coupled of course with the event of the house declining in value' ... It is clear from the finding of the Commissioners that the respondent (employee) was receiving under his service agreement the full salary appropriate to the appointment he held; the housing scheme pursuant to which the housing agreement was made was introduced by I.C.I, not to provide increased remuneration for employees but as part of a general policy to secure a contented staff and to ease the minds of employees compelled to move from one part of the country to another as the result of the company's action …".

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1 (1959) 3 All E.R. 817.
2 (1965) 2 All E.R. 121.

In our opinion the facts before us are readily distinguishable from those in **Hochstrasser's** case[1]. There we have the classic example of two distinct collateral agreements which quite clearly could exist side by side and which could stand one independently of the other. The service agreement could be terminated by either party by merely giving 3 months' notice, but not so the housing agreement. In the case before us we have a single service agreement consisting of regulations and circulars which give rise to a multitude of contractural rights and obligations none of which can exist and be enforced independently of the service agreement. Above all, the object of the housing scheme was to guarantee the employee against any loss which might result from the purchase of a house; it was something quite distinct from the principal agreement of service and remuneration. As against this, the main object of the O.E.A. scheme is – and we so find – to improve the serving conditions of the officers to make them happier and more contented and to enhance their income by relieving them partly of their personal obligations.

8. Taking all the surrounding circumstances into consideration, we have arrived at the conclusion that, unlike **Hochstrasser** case[1], we do not have here a distinct or separate collateral agreement and that the allowance received by the Taxpayer is derived from or arises out of one inseparable service agreement. In arriving at such conclusion, we have not overlooked the fact that the Taxpayer receives his normal salary for an officer of his grade.

9. We now deal with the other limb of his submission on the first ground of appeal, namely that the O.E.A. received does not arise from his employment because it is not remuneration for services rendered under his service agreement. This appears to us to be the crux of the appeal. Depending on what our finding on this issue is, it seems that it is not really necessary to consider the question of whether or not there is a collateral agreement. As Viscount Simonds points out in the **Hochstrasser** case[1] *{supra* at p. 822):-

> "… I do not apologise for going back to the very words of the statute ... nor do I think it is useful to examine whether an agreement under which payment is made is 'collateral'. The question is one of substance and not form. I accept, as I am bound to do, that the test of taxability is whether from the stand point of the person who receives it the profit accrues to him by virtue of his office".

On this part of the Taxpayer's argument we think we should bear in mind that in **Hochstrasser's** case[1], Lord Radcliffe was careful to explain that while it is not sufficient to render a payment assessable that an employee would not have received it unless he had been an employee, it is assessable if it has been paid to him in return for acting as or being an employee *{supra* at p. 823).

10. The principles enunciated in the **Hochstrasser** case[1] have since been explained in **Laidler v. Perry**[2]**.** That is a case in which the Directors of a Company gave their staff at Christmas each year vouchers of £10 each to be spent in shops of their choice. It is clear from an examination of this later decision of the House of Lords that the **Hochstrasser** case[1]

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1 (1959) 3 All E.R. 817.
2 (1965) 2 All E.R. 121.

makes no departure from previous authorities and that the case depends on its own peculiar facts (per Lord Hodgson at p. 127). It is also to be observed that the fact that the employers in the **Hochstrasser** case[1] tried to operate a staff policy which resulted in a contented staff was held to be insufficient in the circumstances of that case to make the compensation received by the employee part of his taxable emoluments, yet the same fact in the circumstances of **Laidler v. Perry**[2] was held to be enough to make the money received in that case income in reward for services and so taxable.

11. In the words of Lord Morris at p. 126:-

> "While it is clear that the taxpayer would not have received the vouchers had he not been a staff employee, the facts as found show that he only received the vouchers because he was a staff employee. He received them only in his capacity as a staff employee. The reason why the vouchers were distributed was that the directors wished to maintain a feeling of happiness among the staff and to foster a spirit of personal relationship between the management and staff. The directors believed that a contented staff was 'a good thing and likely to be of advantage to the group'".

Lord Donovan in his speech at p. 128 remarks that in less round-about language the words last quoted simply mean in order to maintain the quality or services given by the staff and that looked at in this way the payments were an inducement to the recipient to go on working well.

12. Following **Laidler v. Perry**[2]**,** we have come to the conclusion that O.E.A. is paid to the Taxpayer because he is a Government Officer and is received by him in that capacity. We have already stated what our finding is as to the object of the O.E.A. scheme and do not propose the repeat it here.

13. It remains to be added that **Laidler v. Perry**[2] also makes it clear that the fact that the employer benefits from any payment made by him to the employee does not by itself affect the liability of the employee to be assessed on such payment. We mention this because it is part of the Taxpayer's case that Government not only benefits from the O.E.A. scheme financially but from the fact that only officers who have opted for new leave terms are eligible to claim payment. In our opinion, neither factor advances the Taxpayer's case; the second factor even militates against his own argument inasmuch as it forges a link between the allowance paid and his service contract and demonstrates clearly that only officers who have opted to offer their services on certain terms are entitled to claim the allowance in return.

14. We do not think that there is anything which calls for comment as regards **Pritchard (H.M. Inspector of Taxes) v. Arundale**[3] also cited by the Taxpayer as it merely applied the

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1 (1959) 3 All E.R. 817.
2 (1965) 2 All E.R. 121.
3 47 T.C. 680.

general principles stated in the **Hochstrasser** case[1] and reaffirmed that whether any payment arises from an employment depends on the particular facts of each case.

15. The Taxpayer also contends that O.E.A. received by him does not amount to income as it is only reimbursement of expenses incurred by him and hence not assessable. Mr. Benjamin Shih, Chief Assessor who appeared for the Crown, submits, and we think correctly, that this point is concluded by **C.I.R. v. Humphrey**[4] in which it was decided that reimbursement of non-deductible expenses is income and, therefore, assessable. In the **Hochstrasser** case[1] *(supra* at p. 822) Viscount Simonds puts it in another way when he says: "I do not doubt that a taxable profit may take the form of the discharge of an employee's obligation as well as a direct payment".

16. We now come to deal with the second ground of appeal regarding the exemption under section 8(2)(g). This section exempts from tax:-

> "any amount arising from a scholarship, exhibition, bursary, or other similar educational endowment held by a person receiving full time instruction at a university, college, school, or other similar educational establishment".

17. At the hearing, the Taxpayer indicated that he did not wish to pursue this ground except in so far as it asserts that he is taxed on the basis of a family unit. By this he means that his wife's income is included as his income. That being so, he argues that it would be unfair that when it comes to taxation members of the same family should be treated as separate entities. "In the eyes of the Ordinance, we are one person" says he, so that one member of the family could be receiving O.E.A. for the family whilst other members of the family could be receiving full time instruction at a school without the family unit being denied the benefit of the tax exemption granted under section 8(2)(g). In support of his argument, he calls attention to the use of the word "person" in that section and to the definition thereof in section 2(1) of the Ordinance as including a "body of persons".

18. In our opinion, there is no substance in the Taxpayer's argument and we can see no way in which his case can be brought within the ambits of section 8(2)(g). We agree with Mr. Benjamin Shih that it is wrong to say that the Taxpayer is taxed as a family unit. The wife's income is included in the husband's income because by section 10 the income of a wife is expressly deemed to be the income of the husband. There is no similar provision which "deems" the income of a child to be that of the father. Under the Ordinance a married man is taxed on the combined income of himself and his wife and that is as far as it goes.

19. The facts before us negative the suggestion that the allowances were received by the Taxpayer on behalf of his children. The C.S. Regulations make it plain that O.E.A. only becomes payable upon a claim being made by an "eligible officer". The officer pays the expenses first and is reimbursed later. There are also provisions for O.E.A. to be refunded by the officer concerned in certain circumstances. All these are not consistent with the allowances being received by the Taxpayer on behalf of his children. If, for example, the

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[4] H.K.T.C. 451.

Taxpayer should choose not to claim O.E.A. or to apply the same for his own purposes after he has been reimbursed, do the children have any redress against their father? Obviously the answer must be "NO".

20. We have found against the Taxpayer on both grounds and his appeal, therefore, fails. The assessment as determined by the Commissioner is consequently hereby confirmed.