Case No. BR 27/69

Board of Review:

L. J. D'Almada Remedios, *Chairman*, R. S. Sheldon, D. A. C. T. Hancock and F. G. Nigel, *Members.*

25th February 1970.

Salaries tax—grant by company to employee of shares at par value—market value greater than par value—whether grant of shares a perquisite—whether difference in values to be brought into account as representing the value of perquisite for tax purposes—Inland Revenue Ordinance, section 9.

A company made available, subject to certain conditions, to its managing director, the appellant, free of payment, 49 Ordinary shares of the company plus 1 Director's share. The company subsequently decided that the appellant should pay the par value of the 49 Ordinary shares. The market value of the shares, when granted to the appellant, was greater than their par value. The difference in these values was included by the assessor as part of the appellant's assessable income. On appeal.

Decision: Assessment appealed against confirmed.

D. A. S. Hart for the Appellant.

Cases referred to:—

1. Weight v. Salmon, 19 T.C. 174.
2. Abbott v. Philbin, 39 T.C. 82.
3. Ede v. Wilson and Cornwall, 26 T.C. 382.

Reasons:

It is not uncommon, in the business world today, for a person holding a responsible position in a company to be offered, in addition to salary, the privilege of taking up a specified number of the company's ordinary shares at par. Where the par value is less than the market value (as is almost always the case) it has been held, by the House of Lords, that the difference between the amounts subscribed and their actual value was an advantage from an office or employment of profit and was assessable as income : **Weight v. Salmon**[1]. Since then there has been a series of decisions echoing this principle. It is founded on the

[1] 19 T.C. 174, 193.

basis that if an employee receives something, in addition to salary, of potential value, the benefit is assessable because it is "income" according to ordinary usages and concepts if received as a reward or return for services rendered or to be rendered. As section 8 of our Inland Revenue Ordinance (which is the charging section for Salaries Tax) imposes a tax on "income . . . from any office or employment of profit" we are unable to say that the English cases do not apply and, in our view, we are entitled to look to the U.K. decisions for guidance. Even without guidance from the authorities we would have though that a stock benefit granted to an employee at par is a perquisite because the employee has been given the benefit of something the value of which is more than what it has been purchased for. This has been authoritatively decided in **Abbott v. Philbin**[2]. If the grant is subject to a non-assignability clause, the principle remains unaffected although the value to the holder would not be the full difference between the par and market value: **Ede v. Wilson and Cornwall**[3].

In the case with which we are concerned, the appellant is the Managing Director of a Company. He was originally employed under a contract of service for 3 years. In December 1965, his contract was further extended on terms which, *inter alia*, included an agreement as evidenced by a Board of Directors' minute dated 3rd December 1965 to make available to the appellant, free of payment, 49 of the HK$100.00 Ordinary shares of the company, plus 1 Director's share, making a total of 50 shares, subject to the following conditions :—

1. these 50 shares to be held by the Company for and on behalf of the appellant so long as he was in the employ of the Company;

2. dividends accruing on these shares to be paid to the appellant, commencing with the dividend declared for the years ended 1965 to 1967;

3. should the appellant cease to be employed by the Company, the 50 shares allocated are to be transferred back to the Company on payment to the appellant of the face value HK$100.00 per share;

4. in the event of the liquidation of the Company, for any reason whatsoever, the appellant is to receive the net asset value of his holding of 50 shares based on the assets available for distribution at the date of liquidation.

At a subsequent meeting of the Directors of the Company it was decided that the appellant should pay the par value of the 49 shares.

The Commissioner valued these shares at $850 per share. As the appellant was given a bonus of $4,900 to purchase 49 shares at their par value of $100 per share, the Commissioner included as part of his assessable income the following items :—

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[2] 39 T.C. 82.

[3] 26 T.C. 382.

Bonus to purchase shares	$ 4,900
Value, of beneficial share issue (including Director's share)	$37,600

The case of the appellant is that the amount of $37,600 being the "value of beneficial share issue" is not a perquisite and, therefore, not income chargeable to tax. The contention is founded on the argument that the appellant paid for these shares at the rate of $100 a share; that the appellant's employment can be terminated; that the appellant was given a bonus of $4,900 to be utilized in taking up the 49 shares in the company which shares could only be encashed for $4,900 only on termination of his employment so that only the bonus is assessable and not the value of the beneficial share issue in the sum of $37,600.

In our view, these arguments do not take into account what must first be determined, namely : were the shares acquired at a price representing their actual value? If not, did the shares have a greater value than that for which they were acquired? If the answer to the last question is in the affirmative, then, on the decided cases the grant is a perquisite which must be taken into account for tax purposes.

In the course of the hearing, Mr. D. A. S. Hart representing the appellant was asked whether any issue or dispute is taken as to the value of the shares should the Board come to the conclusion that tax is leviable as a perquisite. The Board was informed in reply that in that event there is no dispute that the sum of $850 per share represents a fair value as determined by the Commissioner, and in fact we have observed that in the Balance Sheet of the company as at 31st of March 1966, the figure given for the proposed dividend is $115,000 which amounts to approximately 50% of the issued share capital. In the previous year, the dividend was $112,550. In this respect we have noted that the ground of appeal challenges only the principle of liability to tax in this instance.

We have noted the provision as to the Company holding its own shares but it seems no part of our function to query the effectiveness or legality of such arrangements; the parties to the arrangement were satisfied apparently as to their efficacy and we are firmly of the opinion that the grant of the shares to the appellant is a perquisite and since the shares have a greater value than the price paid for them, the difference must be brought into account as representing the value of the perquisite for tax purposes. We are unable to accept the argument that the shares could only be encashed for $4,900. There were various ways in which the appellant could receive more than $100 per share, thus the true value is not restricted to that figure. As Mr. Hart has rightly pointed out, the value is to be taken at the date when the shares were granted. In our view, value is ascertained not by waiting to see what happens in the event of the appellant's services being terminated. That is merely a contingency which may or may not happen. The value is to be fixed at the time he became entitled to the shares. For these reasons, and as there is no dispute as to the value of the shares, the assessment as regards this aspect of the appeal is confirmed.

In regard to the second ground of appeal which relates to the question of rental value, we find the following facts on the evidence. In the year ended the 31st of March 1966 the total rent paid by the appellant was in the sum of $19,200 calculated at the rate of $1,600 per month. The total refund of rent from his employers for that year amounted to $13,500. The sum of $5,700 is, therefore, the amount the appellant paid out of his own pocket for rent. He also paid a sum of $3,060 representing rates for that period. However, having regard to the wording of s. 9(1)(*c*) of the Ordinance, we are of the opinion that what the appellant paid for rates cannot be reckoned for the purpose of computing the amount payable for rental value. In view of our findings, we direct that the Commissioner's assessment as shown in Sheet V of his Determination be amended by deleting the figure of $3,900 against the item "Less amount deemed to be rent paid by employee" and substituting therefore the figure of $5,700 thereby bringing the total assessable income to $109,214 instead of $111,014.