Case No. D8/13

Salaries tax – income from employment – sections 8(1) & 9(1)(a) of the Inland Revenue Ordinance ('the IRO').

Panel: Cissy K S Lam (chairman), Chak Ming Chan and Choi Kwan Wing Kum Janice.

Dates of hearing: 23 April 2013 and 2 May 2013.
Date of decision: 10 June 2013.

The Appellant claimed that a payment received by him during his employment with Company A named as the '2008 Performance Bonus' was not income from employment within the meaning of section 8(1) of the IRO.

In 2005, the Appellant was employed by Company A under a letter of employment ('the Employment Letter'), which could be modified by mutual agreement. Company A was a member of a group of companies which included Company C. Company C was once a prominent global investment bank and securities trading and brokerage firm. In 2008, Company C was in financial crisis because of the toxic securities and was to be acquired by Company G. A letter was sent by Company A to the Appellant ('the Transition Letter') offering him to stay on with Company A and be responsible for helping with the orderly transition and integration of Company C with Company G through the Transition Period, which was about 2 and a half months. The Transition Letter entitled the Appellant to receive, among others, the 2008 Performance Bonus upon Company A's receipt of his executed Agreement of Release and his completion of the Transition Period. Further, under the Transition Letter, the Appellant surrendered no right but got more than what he originally bargained for in the Employment Letter.

The Appellant eventually signed the Transition Letter and received the 2008 Performance Bonus. According to the accountants' answer to the Assessor's enquiries in respect of all the employees made redundant including the Appellant, the 2008 Performance Bonus was paid 'for services rendered by the individuals during the performance year 2008'.

The Appellant said that the 2008 Performance Bonus was paid 'to keep his mouth shut basically in the future'. He alleged that the Agreement of Release was to prevent him from taking part in stockholder action for fraud against Company C or in assisting others to do so.

Held:

1. Income chargeable under section 8(1) of the IRO 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'. '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.' (See Fuchs v CIR [2011] 2 HKC 422, 430F-431B)

2. A contractual payment is assessable even if it is only paid upon the end of the employment. Such a payment was not contingent but was part of the bargain upon which the employee agreed to be employed. He would not be paid that sum if his employment had not been terminated, but in receiving the sum, he lost no right but got exactly what he was entitled to get from his employment. It is clearly paid in return for his acting as or being an employee. (See Fuchs, at 431G; Williams v Simmonds 55 TC 17; Dale v de Soissons 32 TC 118; Henry v Foster 16 TC 605 and EMI v Coldicott [1999] STC 803)

3. Even if a payment is not contractually stipulated, it is nonetheless assessable if it is paid as a reward for past service (see Carter v Wadman 28 TC 41); or as an inducement to enter into future services (see Shilton v Wilmshurst [1991] 1 AC 684 and Mairs Haughey [1994] 1 AC 303, HL).

4. In both instances, it can be said that the employment was the effective cause or *causa causans* of the payment as opposed to the incidental cause or *causa sine qua non* (see Hochstrasser v Mayes [1960] AC 376).

5. It is only where the payment is made not pursuant to any contractual right but in consideration of the employee agreeing to surrender or forgo his contractual rights that the payment is not assessable (see Fuchs, at 435B). Sum A in Fuchs was such a sum. By reason of the early termination, the taxpayer lost his right to be remunerated down to the end of his three-year term and received Sum A as compensation. A sum for damages for wrongful dismissal is another good example (see also Henley v Murray 31 TC 351, CA; Comptroller-General of Inland Revenue v Knight [1973] AC 428, PC and Hunter v Dewhurst 16 TC 605). Such compensation is the 'something else' referred to by Ribeiro PJ in Fuchs.

6. The 'something else' may also be a payment during employment but totally unrelated to the taxpayer as an employee, such as a personal gift to the employee at his wedding banquet or a one-off Christmas gift (see Laidler v Perry [1966] AC 16) or a payment to compensate the taxpayer not as an employee but as a house owner as in Hochstrasser v Mayes (see Fuchs, at 431E-F) where the employee had to sell his house at a loss when despatched to work in a different location and was compensated for such a loss. The present case clearly falls outside this category of 'something else'.

7. The Appellant's entitlement to the 2008 Performance Bonus arose from the Transition Letter, although the execution of Agreement of Release as well as the completion of the Transition Period were pre-conditions to its payment. By accepting the Transition Letter, the 2008 Performance Bonus became a contractual payment which Company A was bound to pay and the Appellant was entitled to receive. It was the Appellant's contractual right from his employment to receive the bonus.

8. The 2008 Performance Bonus was not assessed in accordance with the Employment Letter. It was paid on a discretionary basis but it was nonetheless a payment for the services that the Appellant had rendered and continued to render in 2008. It was a reward for past services and an inducement to continue to perform services until the termination of his employment.

9. The Transition Letter and Agreement of Release served proper commercial objectives and were necessary as part of the merger/take over exercise. They were not intended to 'shut up' the Appellant as alleged.

10. The 2008 Performance Bonus satisfied the test in Fuchs. It was a payment 'in return for acting as or being an employee' and 'as a reward for past services and as an inducement to continue to perform services'. It was not paid for 'something else'. It was income from his employment within the meaning of section 8(1)(a) of the IRO.

Appeal dismissed.

Cases referred to:

Fuchs v CIR [2011] 2 HKC 422
Hochstrasser v Mayes [1960] AC 376
Shilton v Wilmshurst [1991] 1 AC 684
Williams v Simmonds 55 TC 17
Dale v de Soissons 32 TC 118
Henry v Foster 16 TC 605
EMI v Coldicott [1999] STC 803, CA
Carter v Wadman 28 TC 41
Mairs Haughey [1994] 1 AC 303
Henley v Murray 31 TC 351, CA
Comptroller-General of Inland Revenue v Knight [1973] AC 428
Hunter v Dewhurst 16 TC 605
Laidler v Perry [1966] AC 16

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Yim Kwok Cheong, Leung Kin Wa, Ong Wai Man Michelle and Ng Lai Ying Vivian for the Commissioner of Inland Revenue.

Decision:

1. The Appellant objected to his salaries tax assessment for the year of assessment 2008/09. He argued that a sum labelled '2008 Performance Bonus' was not income within the meaning of section 8(1) of the Inland Revenue Ordinance ('the IRO'), Chapter 112.

The Employment Letter

2. The Appellant commenced employment with Company A in 2005. Company A was a member of the group of companies B ('Group B'), with Company C in City D, Country E as the ultimate holding company. Company C was a once prominent global investment bank and securities trading and brokerage firm.

3. The terms of his employment were contained in the letter dated XX-XX-2005 ('the Employment Letter'). He received the Company title of Managing Director. His position was in Department F based in Hong Kong.

4. Clause 4 provided for his remuneration which comprised an annual salary (payable monthly) and a bonus. Sub-clauses 4(b), (c) and (d) set out in some details how the bonus for the fiscal years 2005 and 2006 would be calculated and payable. The Appellant was promised a 'Minimum Bonus' in cash and stock options. The 'bonus paydate' for the two fiscal years were anticipated to be in January 2006 and January 2007 respectively.

5. Sub-clause 4(e) provided for a discretionary bonus after 2006. Provided that the Appellant was an employee in good standing on the bonus payday, the Appellant might be awarded a discretionary bonus based on Company A's overall performance, the Department's performance and the Appellant's performance.

6. By clause 11 the Appellant's employment could be terminated by either party giving 90 days' notice in writing or 90 days' salary in lieu of notice.

7. By clause 12 the terms of the Employment Letter could be modified by the mutual agreement of the parties made in writing and executed by both parties.

The Transition Letter

8. On 14 May 2008, the Appellant received a letter from Company A ('the Transition Letter') regarding 'Merger Arrangements'. It recited the agreement and plan of merger dated 16 March 2008 as amended (the 'Merger Agreement') between Company C and Company G and confirmed that the Appellant had been identified as a 'Transition Employee'. It offered the Appellant the opportunity to stay on with Company A and be responsible for helping with the orderly transition and integration of Company C with Company G through the 'Transition Period', defined as the period from 17 March 2008 to the 'Transition End Date', then expected to be 31 May 2008.

9. The Transition Letter entitled the Appellant to receive an ex-gratia severance payment and the '2008 Performance Bonus' upon Company A's receipt of his executed Agreement of Release. It stated 'Note also' that the Appellant must complete the Transition Period in order to be eligible for the payments. If the Appellant's employment was terminated for Cause or if he resigned from his employment before the Transition End Date, he would not be eligible for any payments described therein.

10. The '2008 Performance Bonus' is the sum currently in issue. Under the Transition Letter the Appellant was eligible to receive 'an ex-gratia payment which will be a minimum of 25% of your total 2007 bonus including any equity component, if applicable. Payment of this ex-gratia payment is conditional on your continued adherence to your employment obligations during the Transition Period and thereafter your signing and returning of' the Agreement of Release.

11. It is clear to this Board that the entitlement to the 2008 Performance Bonus arose from the Transition Letter, although the execution of Agreement of Release as well as the completion of the Transition Period were pre-conditions to its payment.

12. A draft Agreement of Release was attached to the Transition Letter. The amount of performance bonus was left blank in the draft. He was given the figure on a separate piece of paper a few days later. According to his evidence the Appellant needed time to consider the Transition Letter before making 'an informed decision'. He eventually signed the Transition Letter a few days before 31 May 2008. By the time he decided to sign the Transition Letter, he had all the figures at hand.

The Agreement of Release

13. The final Agreement of Release dated 31 May 2008 (the 'Agreement of Release') was signed and accepted by the Appellant on 2 June 2008.

14. Clause 1 referred to the Transition Letter and confirmed that the Appellant's employment would be terminated with immediate effect ('the Last Date') by Company A paying the Appellant wages in lieu of 3 months' notice.

15. Clause 2 set out the 'contractual and statutory entitlements' which included unused annual leave, salary and benefits up to the Last Date, payment in lieu of notice and severance payment.

16. Clause 3 set out the 'ex-gratia payment' which comprised (i) an ex-gratia severance payment of HK$4XX,XXX and (ii) a performance bonus of HK$5,XXX,XXX.

17. Clause 4 made provisions for medical benefits and housing allowance for the period of 3 months from the Last Date.

18. Clause 5 set out the time for payment. The 'contractual and statutory entitlements' payable under Clause 2 would be paid within 7 days of the Last Date irrespective of whether the Appellant signed the Agreement of Release. The payments and arrangements set forth in Clause 3 and 4, on the other hand, would only be made if the Appellant executed the Agreement of Release within 5 days of the Last Date.

19. Clause 6 was titled 'Release'. It stipulated that the Appellant accepted that the payments set forth therein as full and final settlement of all and any claims and rights of action that he had or might have against Company A and Group B (defined therein to include Company G) arising out of or in connection with his employment and its termination.

20. Clauses 7 and 8 dealt with 'confidentiality' and other 'post-employment matters'.

The Appellant's earnings 2005 to 2008

21. The Appellant duly received the 2008 Performance Bonus as well as other payments stipulated in the Transition Letter and Agreement of Release. The Appellant's earnings during his employment with Company A may be summarized as follows:

Table 1

	A	B	C	D	E
Year of assessment	2004/05	2005/06	2006/07	2007/08	2008/09
Period	XX-XX-2005–31-3-2005	1-4-2005–31-3-2006	1-4-2006–31-3-2007	1-4-2007–31-3-2008	1-4-2008–31-5-2008
	$	$	$	$	$
Salary	5X,XXX	1,XXX,XXX	1,XXX,XXX	1,XXX,XXX	3XX,XXX
Leave Pay					1XX,XXX
Bonus	1XX,XXX	3,XXX,XXX	7,XXX,XXX	9,XXX,XXX	
Allowance	3X,XXX	7XX,XXX	7XX,XXX	1,XXX,XXX	

Table 1

	A	B	C	D	E
Year of assessment	2004/05	2005/06	2006/07	2007/08	2008/09
Period	XX-XX-2005–31-3-2005	1-4-2005–31-3-2006	1-4-2006–31-3-2007	1-4-2007–31-3-2008	1-4-2008–31-5-2008
	$	$	$	$	$
Other rewards					5,XXX,XXX
Total	2XX,XXX	5,XXX,XXX	9,XXX,XXX	1X,XXX,XXX	6,XXX,XXX

22. The figures in Columns A to D are taken from the Employer's Return of Remuneration and Pensions of the relevant years of assessment. The figures in Column E are taken from the Notification by an Employer of an Employee who is about to cease to be employed filed by Company A dated 9 July 2008 ('the Notification').

23. The 'other rewards' of $5,XXX,XXX in Column E was made up of the 2008 Performance Bonus of $5,XXX,XXX plus a housing allowance of $1XX,XXX. In addition to the payments set out in Column E above, the Appellant also received the following sums as per the Appendix attached to the Notification:

	$
Statutory Severance Payment	4X,XXX
Ex-gratia Severance Payment	4XX,XXX
Payment in Lieu of Notice	7XX,XXX

The assessment and the appeal

24. The Assessor considered that the 2008 Performance Bonus was chargeable to salaries tax and assessed the Appellant accordingly. The Assessor later revised his assessment with some minor adjustments. The revised assessment was confirmed by the Deputy Commissioner of Inland Revenue ('the Commissioner') by his Determination dated 19 September 2012 ('the Determination'). Dissatisfied with the revised assessment, the Appellant appealed to this Board.

25. His grounds of appeal were that the 2008 Performance Bonus was not income within the meaning of section 8(1) of the IRO; the facts upon the Determination was arrived at was materially incomplete and inaccurate and the authority of Fuchs v CIR was wrongly applied to the facts.

The Appellant's evidence

26. The Appellant produced a written witness statement dated 13 March 2013 and gave oral testimony before us which mostly recited his witness statement. As a witness the Appellant was eloquent and persuasive. A visibly intelligent young man, he knew his arguments well. Nevertheless it is clear to us that he had failed to truly appreciate the underlying commercial objectives of the Transition Letter and the Agreement of Release.

27. The Appellant told us he worked in Department F ('the Department') selling equity products to institutional clients. It was a global team because he was selling products from Europe and the US to clients in the Asian time zone. He started as Managing Director and was later promoted to Senior Managing Director.

28. The performance evaluation would take place in about November of each year. It was an across the board exercise, done by way of meetings between employees and their superiors. His individual performance would be discussed as well as the performance of the Department as a global team and the performance of the entire Group B. The bonus amount would be announced in December and paid in the following January to tie in with the fiscal year of Company C. The 'bonus payday' was a once-a-year event. There was no ad hoc performance evaluation or bonus payment. And no bonus would be payable to anyone leaving, or who had already left, the employ of the company on the bonus payday.

29. The sudden collapse of Company C was a complete shock to him and his colleagues. He was totally unaware of Company C's liquidity problems before March 2008. Information first leaked into the financial market about Company C's liquidity problems on 10 March 2008. On 13 March 2008, further news emerged that Company C was forced to seek emergency financing from the Central Bank of Country E ('the Central Bank') and Company G. On Sunday, 16 March 2008, it was announced that Company G was purchasing Company C with the help of the Central Bank. By midday 17 March 2008, the price of Company C stock had plummeted to US$4.30 per share, a free fall from its height of US$160 in April 2007.

30. Stockholders reacted bitterly to the proposed acquisition. Class action lawsuits were filed on behalf of stockholders alleging, amongst other things, that Company C and several of its officers had carried out a fraud upon their stockholders in violation of securities laws of Country E. The first class action was instituted on 17 March 2008 (see Annex D of the witness statement). Their number eventually grew to as many as twenty-two. Subsequently on 24 March 2008, Company G agreed to revise the acquisition package raising its offer to US$10 per Company C share from the initial US$2. Further, Company G would assume losses on the first US$30 billion of the illiquid or 'toxic' securities in Company C's portfolio while the Central Bank would assume the next US$29 billion of losses.

31. Since the turn of events on 16 March 2008 the Appellant was left with little to do except to provide after-sales services for existing transactions.

32. It was on 14 May 2008 that he received the Transition Letter. Many of his fellow Senior Managing Directors received substantially the same offer letters on the same day. There were particular aspects of the Transition Letter which 'intrigued' him. It purported to offer him 'the opportunity to stay on', 'continue to be an active employee' and 'continue to receive the same salary' retrospectively from 17 March 2008. It was artificial because he had been in active employment and receiving salary up till that time anyway. The last day was only two weeks away on 31 May 2008. He did not believe it was their true intention to offer him the 'opportunity to stay on' for only a few working days.

33. He discussed the situation with his superior, Mr J, who confirmed that he had never reported the Appellant's performance to upper level management for the purpose of the lay-off exercise. No 2008 performance evaluation was conducted. The so-called '2008 Performance Bonus' had nothing to do with any actual performance of the Appellant or the corporate side. The Appellant tried to bargain for a higher figure, but was told to take it or leave it.

34. The Appellant took the view that the Transition Letter was redundant and the whole exercise was to induce him to sign the Agreement of Release. He made particular references to clauses 6, 7.3 and 8.1 of the Agreement of Release and went on to allege that these clauses were inserted to make him 'shut up'. He repeatedly tried to impress upon us that he was a senior personnel and as such held materials which he could have used in his own action against Company C or in assisting in class actions by others. He told us that there were talks of class action on behalf of employees of Company C in Country E. Such class actions were of employees suing in the capacity of stockholders for fraud in violation of the securities laws of Country E. He referred to an article in Newspaper K which reported on a US$275 million settlement of a stockholder lawsuit against Company C. That article was dated 7 June 2012. Following that article was an article published by Law Firm L on a web page of Newspaper K on 8 June 2012. It said that 'in light of the just announced settlement of Group B shareholder class action claims, we are reprinting our May 2008 press release about the opt out alternative.' That May 2008 press release compared the respective merits of class action litigation versus opt out litigation. It referred to statistical studies and evidence of other securities class action and advised that Group B employees could recover a higher settlement in individual opt out cases.

35. The Appellant was a holder of Company C stocks which he obtained as part of his 2005 bonus. The Summary of Upfront Restricted Stock Units ('RSU') showed that the RSU were distributed to him in May 2007 at a taxable amount of over HK$6XX,XXX. The Appellant told us in cross-examination that he sold those stocks after 2008 for just a few thousand dollars.

36. After discussing with his superior and colleagues and doing extensive research on the web and weighing his options as 'a businessman', he ultimately made an 'informed decision' to sign the Transition Letter which he did a few days before 31 May 2008.

37. To summarize, the gist of the Appellant's case was that: (1) The 2008 Performance Bonus although labelled as a 'bonus' was not paid pursuant to clause 4(e) of the Employment Letter. It was not paid on the bonus payday and with the collapse of Company C, there was no evaluation of performance. (2) The top management of Company C had fraudulently misled staff and stockholders alike about the true financial health of the company. (3) The Transition Letter was redundant. It lasted for only two weeks and he had to work through the two weeks in any event under the Employment Letter. There was no good reason to pay him the bonus except to induce him to sign the Agreement of Release so as to prevent him from taking part in stockholder action for fraud against Company C or in assisting others to do so. To use his own words: 'they want to keep my mouth shut basically in the future by paying me that amount of money'.

38. We shall deal with these points in detail below. But we wish to make it clear here that if the Appellant really believed that the purpose of the Agreement of Release was to keep his mouth shut or to make him side with Company C in subsequent legal proceedings, then he was seriously mistaken.

Relevant sections of the IRO

39. By section 8(1)(a), salaries tax shall be charged on every person in respect of his income arising in or derived from Hong Kong from any office or employment of profit.

40. By section 9(1)(a), income from any office or employment includes any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite or allowance, whether derived from the employer or others.

Fuchs v CIR

41. The one issue in this appeal is whether the 2008 Performance Bonus is income from an office or employment within the meaning of section 8(1)(a) above. This same issue was examined with an extensive review of the authorities by the Court of Final Appeal in Fuchs v CIR [2011] 2 HKC 422.

42. Ribeiro PJ started by quoting from Hochstrasser v Mayes [1960] AC 376, HL, at 388 (see Fuchs, 429F-H). In that case, Lord Radcliffe stated:

> '*The test to be applied is ... contained in the statutory requirement that the payment, if it is to be the subject of assessment, must arise "from" the office or employment. ... I think that their meaning is adequately conveyed by saying 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.*'

43. In the same case, Viscount Simonds approved Upjohn J's statement in the lower court as follows:

> ' *... the authorities show that to be a profit arising from the employment the payment must be made in reference to the services the employee renders by virtue of his office, and it must be something in the nature of a reward for services past, present or future.*'

44. Ribeiro PJ next quoted from Shilton v Wilmshurst [1991] 1 AC 684, HL at 689 where Lord Templeman expanded on the test:

> ' *.... the section must therefore apply first to an emolument which is paid as a reward for past services and as an inducement to continue to perform services and, secondly, to an emolument which is paid as an inducement to enter into a contract of employment and to perform services in the future. The result is that an emolument "from employment" means an emolument "from being or becoming an employee." The authorities are consistent with this analysis and are concerned to distinguish in each case between an emolument which is derived "from being or becoming an employee" on the one hand, and an emolument which is attributable to something else on the other hand, for example, to a desire on the part of the provider of the emolument to relieve distress or to provide assistance to a home buyer. ….*'

45. Following these dicta, Ribeiro PJ stated the test as follows (430F-431B):

> ' *Income chargeable under [section 8(1) of the IRO] 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).*
>
> *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".*'

46. In Fuchs, the taxpayer was employed likewise by a bank for a fixed term of three-year. In the event of early termination, clause 9(c) of his employment contract provided for the payment of two sums, namely (1) two annual salaries and (2) an average amount of the bonuses paid in the three previous years of employment, as 'agreed compensation or liquidated damages'. Before the end of the three year term, the employer bank was taken over by another bank and as part of the resultant re-organisation, the taxpayer's employment was terminated. A termination agreement was made between him and his employer under which the taxpayer was paid three sums called A, B and C therein, (1) Sum A being a sum equivalent to the taxpayer's salary for the remaining term of the employment contract (12 months); (2) Sum B being two annual salaries and (3) Sum C being the average amount of the bonuses paid in the three previous years. As is apparent Sum A was compensation for the taxpayer's loss of earnings for the remaining term of the contract and Sums B and C represented the two sums originally stipulated in the contract of employment.

47. Sum A was accepted as being compensation for the early termination and not taxable. Sums B and C, however, were found by the Court of Appeal and the Court of Final Appeal as payment made pursuant to clause 9(c) of the employment contract and assessable. Ribeiro PJ concluded at page 437, paragraph 26:

> *' It follows, in my view, that Sums B and C were paid in satisfaction of the rights which had accrued to the taxpayer under clause 9(c) and were plainly amounts derived "from his employment". They were not sums paid in consideration of the abrogation of the taxpayer's rights under the employment contract. Like Colonel de Soissons [in Dale v de Soissons (1950) 32 TC 118], Mr Fuchs surrendered no rights. Instead, by negotiation, he augmented his clause 9(c) rights by securing an additional year's salary represented by Sum A. Sums B and C accordingly come within the charge to salaries tax contained in section 8(1). This conclusion is reached on reasoning which proceeds much along the lines of the Court of Appeal's approach.'*

48. On the authority of Fuchs, a contractual payment is assessable even if it is only paid upon the end of the employment (see Fuchs, at 431G). Such a payment was not contingent but was part of the bargain upon which the employee agreed to be employed. He would not be paid that sum if his employment had not been terminated, but in receiving the sum, he lost no right but got exactly what he was entitled to get from his employment. It is clearly paid in return for his acting as or being an employee – see also Williams v Simmonds 55 TC 17; Dale v de Soissons 32 TC 118; Henry v Foster 16 TC 605 and EMI v Coldicott [1999] STC 803, CA, in which the authorities were also extensively reviewed by the English Court of Appeal.

49. Even if a payment is not contractually stipulated, it is nonetheless assessable if it is paid as a reward for past service – see also Carter v Wadman 28 TC 41; or as an inducement to enter into future services – see Shilton v Wilmshurst above and Mairs

Haughey [1994] 1 AC 303, HL.

50. In both instances, it can be said that the employment was the effective cause or *causa causans* of the payment as opposed to the incidental cause or *causa sine qua non* – see Hochstrasser v Mayes above.

51. It is only where the payment is made not pursuant to any contractual right but in consideration of the employee agreeing to surrender or forgo his contractual rights that the payment is not assessable (see Fuchs, at 435B). Sum A in Fuchs was such a sum. By reason of the early termination, the taxpayer lost his right to be remunerated down to the end of his three-year term and received Sum A as compensation. A sum for damages for wrongful dismissal is another good example. See also Henley v Murray 31 TC 351, CA; Comptroller-General of Inland Revenue v Knight [1973] AC 428, PC and Hunter v Dewhurst 16 TC 605. Such compensation is the 'something else' referred to by Ribeiro PJ in Fuchs.

52. The 'something else' may also be a payment during employment but totally unrelated to the taxpayer as an employee, such as a personal gift to the employee at his wedding banquet or a one-off Christmas gift (see Laidler v Perry [1966] AC 16) or a payment to compensate the taxpayer not as an employee but as a house owner as in Hochstrasser v Mayes (see Fuchs, at 431E-F) where the employee had to sell his house at a loss when despatched to work in a different location and was compensated for such a loss. The present case clearly falls outside this category of 'something else'.

This Board's Decision

53. Riberio PJ reminded us that '*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*' (see Fuchs, 434H).

54. We ask ourselves the same questions: In the light of the terms on which the Appellant was employed and the circumstances of the termination, was the 2008 Performance Bonus in substance 'income from employment'? Was it paid in return for his acting as or being an employee? Was it paid as a reward for past services and as an inducement to continue to perform services? Our answer is yes.

55. ***It was a contractual payment***: The Employment Letter could be modified by mutual agreement. By signing and accepting the Transition Letter, the Appellant agreed to abide by the terms of the Transition Letter and to continue his employment until its termination on those new terms. The Appellant did not sign the Transition Letter until a few

days before 31 May 2008, but he was given the Transition Letter on 14 May 2008. The Appellant knew as from 14 May 2008 that if he agreed to stay on until the merger which at that time was anticipated to be 31 May 2008, he would get paid for the five months that he had worked for Company A which included both his salary and his bonus. He made 'an informed decision' to sign and accept the Transition Letter. By so doing, the Appellant was accepting the 2008 Performance Bonus as part of his bargain for staying on until the end of the merger and to terminate his employment on the revised terms and Company A became contractually bound to make the payment. The 2008 Performance Bonus was a contractual payment. It was a reward for his 'acting as and being an employee' and an inducement 'to continue to perform services'. It clearly 'derived from his employment' albeit the terminal part of his employment.

56. ***The Transition Letter and Agreement of Release served proper commercial objectives***: The Appellant said that the Transition Letter lasting for only two weeks was redundant. We disagree. The Appellant failed to appreciate that when in the preamble the Transition Letter stated that he was offered 'the opportunity to stay on with [Company A] and be responsible for helping with the orderly transition and integration of [Company C with Company G] through the Transition End Date', the Transition Letter was not paying lip service to the important role of the Appellant as a Transition Employee. It was genuinely important to Company C and Company G for there to be a smooth transition and a successful integration that outgoing employees should agree to terminate their employment on the new terms which are binding not only between them and Company A or Company C, but also between them and Company G.

57. Much ado had been made about the Transition Letter and the Agreement of Release by the Appellant, especially in his oral testimony. He seemed to suggest that they were anomalous creatures invented by Company C or Company G because of the troubles surrounding Company C in the 2008 financial crisis. They were nothing of the kind. Similar documents have come up before the Board of Review previously as demonstrated by the authorities placed before us. They serve useful and practical purposes in a merger or take over. They are necessary in order that the employee is bound not only by his employment contract with his original employer, which may or may not exist after the merger or take over, but also with the buyer and the merged company. So under the Transition Letter under the heading 'Employment Status', the Appellant remained subject not only to all of the employment obligations under his employment agreement with Company A but also 'to all of [Company A], [Company C] and relevant [Company G's] current rules, regulations and practices during the Transition Period and … notice period'. The Transition Letter ended by stating that any change to the letter must have proper written approval from both Company A and Company G. And in the Agreement of Release, Group B was given an extensive definition to include Company G.

58. ***Employment related liabilities are settled***: A merger will inevitably result in a duplication of staff. Some members of staff will have to go. As recited in the preamble of the Transition Letter, as a result of the Merger Agreement a process was underway to identify employees for whom there was a suitable role within Company G. The Appellant

was not one of them. He was identified as a Transition Employee. For those outgoing employees, it was necessary for Company G, as for any purchaser in a take over, to know exactly what liability they had to shoulder in terms of outstanding salaries, bonuses, allowances, payment in lieu, etc. Once the outgoing employees signed and accepted the Transition Letter and subsequently the Agreement of Release, all outstanding liability would be crystallized and no further liability would be carried to the merged company. Clause 6 of the Agreement of Release was clearly intended for this purpose. Clause 6.1 stipulated that the Appellant accepted that the payments set forth therein as full and final settlement of all and any claims and rights of action that he had or might have against Company A and Group B (defined therein to include Company G) arising out of or in connection with his employment and its termination in Hong Kong or any other jurisdictions. It went on to make comprehensive references to employment related liabilities including not only liabilities under the Employment Ordinance and the Employees' Compensation Ordinance, but also such ordinances as the Personal Data (Privacy) Ordinance, the Sex Discrimination Ordinance, the Disability Discrimination Ordinance and the Family Status Discrimination Ordinance.

59. Clause 6.2 provided that the Appellant undertook not to institute a claim or issue proceedings against Company A or Group B (as defined therein) in respect of any claim which he had or might have relating to the matters set out in paragraph 6.1 above 'or otherwise'. Mr Man in his submission argued that 'or otherwise' supported the Appellant's alleged belief that the Agreement of Release was intended to prevent him from taking action against Company C as stockholder for fraud. This is taking Clause 6.2 completely out of context and we categorically reject this argument. It is clear to us that Clause 6 of the Agreement of Release aimed no more than to procure a clean break with the Appellant with no outstanding employment related liability.

60. As pointed out by Mr Yim for the Commissioner, if the 2008 Performance Bonus was paid as full and final settlement of all the Appellant's claims including his alleged claim for fraud, the Transition Letter and the Agreement of Release would have made it crystal clear and would not have left such an important term obscurely buried in some general provisions. An action for fraud can be settled as much as an action for wrongful termination of employment. It made no sense to have a comprehensive term like Clause 6 settling all employment related liabilities and yet made no mention of liability for fraud.

61. ***Protection extended to Company G***: Another important purpose of the Transition Letter and the Agreement of Release was to make sure that the protection enjoyed by Company C and its subsidiaries in terms of confidentiality and non-solicitation or non-competition under the Employment Letter would continue to be enjoyed by the merged company despite the merger/take over. Clauses 7 and 8 of the Agreement of Release together with the extensive definition of Group B to include Company G were clearly formulated for this purpose.

62. But again the Appellant sought to impute a different interpretation to Clauses 7.3 and 8.1 which read as follows:

> ' 7.3 The Employee shall cooperate fully with [Group B] in all investigations, claims, litigation and compliance and regulatory matters in which the Employee's assistance may be reasonably requested by [Group B]. Such cooperation shall include, without prejudice to the generality to the foregoing, attending meetings, reviewing or preparing documents and providing any information.'
>
> ' 8.1 The Employee undertakes that the Employee will not, whether directly or indirectly, make, publish or otherwise communicate or allow to be made, published or communicated so far as it is within the Employee's control, any disparaging or derogatory statements, whether in writing or otherwise, concerning [Group B], provided that the Employee will not be prevented from making a disclosure to the proper authorities as required by law. The Employee further undertakes to keep the circumstances on which the Employee's employment is terminated (including the terms of this Agreement) strictly confidential and agrees not to disclose, communicate or otherwise make public the same to anyone (save to the Employee's professional advisers and the relevant tax authorities and otherwise as may be required to be disclosed by law). The Employee also undertakes not to knowingly make, publish or otherwise issue any negative statements concerning the Company or [Group B] or any of their officers or employees.'

63. The Appellant claimed that 'cooperate fully' and 'will not … make any disparaging or derogatory statements' meant he was required to be 'on their side', to join their 'camp' and to shut his mouth. We find nothing in the two sub-clauses to warrant such an interpretation. True it might be that these clauses were written with possible investigations in mind, we find nothing to indicate that the employee was bound to shut up or side with Company C in such investigations or to do anything that is other than honest and proper. The wordings and meaning of sub-clauses 7.3 and 8.1 are plain and need no explanation. We find no basis whatsoever to impute any secondary meaning into them.

64. ***Payment for past services***: In addition to being a contractual payment, the 2008 Performance Bonus was also a payment for past services. We accept that it was not paid in accordance with the strict letters of clause 4(e). Instead of a proper evaluation of the Appellant's performance, it was gauged on the 2007 bonus. But that is far from saying that it was not paid as a reward for the Appellant's performance. Company C was in financial crisis because of the toxic securities, not because they were not earning money. As the Appellant explained to us in his oral testimony, toxic securities such as credit default swap and mortgage-backed securities, etc, were substantially over-valuated in Company C's portfolio and when investors began to challenge the valuations and made a run for their money, the bank could not pay up. That was no indication of whether or how the Appellant

performed in 2008.

65. Although we have no evidence how the figure of $5,XXX,XXX was calculated, the accountants writing on behalf of Company C did state explicitly the purpose of the bonus. In their letter of 13 September 2010 in answer to the Assessor's enquiries in respect of all the 153 employees made redundant including the Appellant, they referred to specimen transition letters and agreements of release and made it clear that the bonus was paid 'for services rendered by the individuals during the performance year 2008'. The 2008 Performance Bonus was not a misnomer but was called a performance bonus for good reasons.

66. It is certainly within an employer's discretion to pay an employee an ex-gratia bonus that is purely discretionary and arbitrary in recognition of his services. As pointed out by Mr Yim, section 9(1)(a) of the IRO expressly includes gratuity or ex-gratia payment as 'income from office or employment'. For proper commercial objectives discussed above, it was in the interests of Company C and Company G as much as in the interests of the Appellant that he be adequately rewarded for his work from January to May 2008. As is apparent from Table 1 above, the predominant part of the Appellant's earnings was always the bonus, not the salary. The Appellant would not be adequately rewarded without his bonus. The 2008 Performance Bonus was a reward for past services and an inducement to continue to perform services until the final day of his employment.

67. ***No abrogation of rights***: Finally we ask ourselves: Was the bonus paid as compensation for the abrogation of the Appellant's contractual rights? Our answer is no. Like the taxpayer in Fuchs, the Appellant surrendered no right but got more than what he originally bargained for in the Employment Letter. There was no 'something else' within the meaning of Fuchs' test.

68. In conclusion, we find as follows:

(1) The Appellant's entitlement to the 2008 Performance Bonus arose from the Transition Letter, although the execution of Agreement of Release as well as the completion of the Transition Period were pre-conditions to its payment. By accepting the Transition Letter, the 2008 Performance Bonus became a contractual payment which Company A was bound to pay and the Appellant was entitled to receive. It was the Appellant's contractual right from his employment to receive the bonus.

(2) The 2008 Performance Bonus was not assessed in accordance with Clause 4(e) of the Employment Letter. It was paid on a discretionary basis but it was nonetheless a payment for the services that the Appellant had rendered and continued to render in 2008. It was a reward for past services and an inducement to continue to perform services until the termination of his employment.

(3) The Transition Letter and Agreement of Release served proper commercial objectives and were necessary as part of the merger/take over exercise. They were not intended to 'shut up' the Appellant as alleged.

(4) The 2008 Performance Bonus satisfied the test in Fuchs. It was a payment 'in return for acting as or being an employee' and 'as a reward for past services and as an inducement to continue to perform services'. It was not paid for 'something else'. It was income from his employment within the meaning of section 8(1)(a) of the IRO.

69. For the reasons above, we reject the Appellant's grounds of appeal. We confirm the Assessor's revised salaries tax assessment for the years of assessment 2008/09 as per paragraphs 1(1) and (13) of the Determination.