

INLAND REVENUE BOARD OF REVIEW DECISIONS

**Case No. D119/02**

**Salaries tax** – income – loans by employer subsequently waived.

Panel: Andrew J Halkyard (chairman), Malcolm John Merry and Christopher John Weir.

Date of hearing: 14 January 2003.

Date of decision: 30 January 2003.

The appellant was a senior inspector of the Hong Kong Police Force. He was awarded a government legal training scholarship. He also received interest-free loans in the total sum of 4,276,310 ('the Sum') from the Government.

Subsequently, the repayment of the loans granted to him was waived by the Government.

The Commissioner assessed the appellant to salaries tax on the Sum.

**Held:**

As the repayment of the loans had been waived by the Government, they fell simply within the meaning of income and thus were liable to salaries tax.

**Obiter:**

Perquisite must include waiving a debt owed by an employee to his employer apart from discharging a debt owed by the employee to a third party (David Hardy Glynn v CIR (1990) 3 HKTC 245 applied).

**Appeal dismissed.**

Cases referred to:

David Hardy Glynn v CIR (1990) 3 HKTC 245  
BR13/74, IRBRD, vol 1, 159  
D83/00, IRBRD, vol 15, 726  
D57/92, IRBRD, vol 8, 54

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D19/92, IRBRD, vol 7, 156  
Clayton v Gothorp [1971] 2 All ER 1311

Ngan Man Kuen for the Commissioner of Inland Revenue.  
Taxpayer in person.

### **Decision:**

1. This is an appeal against a salaries tax assessment for the year of assessment 1997/98. The Appellant claims that he should not be assessed to salaries tax on the amount of \$4,145,510 ('the Sum').

### **The facts**

2. These are not in dispute and we find them as follows:
- (a) In 1990, while the Appellant was employed as a senior inspector of police of the Police Force of the Hong Kong Government ('the Government') he applied for and was awarded a government legal training scholarship ('the Contract').
  - (b) Under the terms of the Contract, the Appellant remained in the employment of the Government but was entitled and required to attend a three-year Bachelor of Laws Degree (LLB) Course plus a one-year Postgraduate Certificate in Laws (PCLL) Course at the University of Hong Kong ('HKU'), followed by either one-year pupillage or two-year articles in a law department to be directed by the Government ('the Study Course').
  - (c) The award of the Contract was made upon the following terms and conditions:
    - 'A. The scholar will be on no-pay leave under CSR 1008(1) throughout the period of training ... The no-pay leave will not be counted for increments, but it will be reckoned as pensionable service. ...
    - B. (a) For training undertaken locally in Hong Kong, the scholar may be eligible for the following training benefits under CSR 1009:
      - (i) an interest-free loan, paid on a monthly basis, equal to 100% of the substantive salary for the entire period of no-pay leave [see CSR 1009(b)(i)]; this loan will be

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treated as taxable income upon Government's granting of a waiver to the repayment liability ...

- D. The scholar will be required to sign, ... an Undertaking ... in accordance with CSR 1005 for which a continuing Guarantee in the form attached thereto for the duration of the undertaking must be provided. ...
  - E. The scholar will be required to sign, in addition to the undertaking, a Bond ... for the loan referred to in para. B above. ...
  - I. Upon successful completion of the training, the scholar will be required to immediately accept appointment if offered by Government to any post which the training has prepared him/her and serve for the period as specified in the undertaking. ...
  - K. If the scholar fails to comply with any of the terms of the undertaking, he/she will be required to repay immediately on demand to Government all monies expended to date in connection with the training in one lump sum, calculated in accordance with the Undertaking and Bond(s) he/she has signed.'
- (d) On 7 September 1990, the Appellant signed an undertaking to the Government in respect of the training provided ('the First Undertaking'). The First Undertaking provided, inter alia, the following clauses:
- 'In consideration of any fees, travel costs, allowances, or other monies which may be paid by or on behalf of the Hong Kong Government to me or on my behalf in connection with the training detailed below, I agree:
- (a) to sit for all prescribed examinations and to use my best endeavours to complete the said training successfully; ...
  - (c) following conclusion of the training and upon completion of recruitment formalities, to take up appointment if offered to the post of Legal Officer in the Government on such terms (including appointment on probation or trial as defined in the relevant Civil Service Regulations) as shall be offered by the Government; and
  - (d) to continue in the service of the Government in the said post, ... for a period of not less than five years starting from the date of appointment to the said post unless my service has been sooner terminated by the Government.

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2. Should my work or conduct during the training be, in the opinion of the Secretary for the Civil Service, unsatisfactory, or should I fail to sit for any prescribed examination, or should I fail to complete the training successfully within the time specified ... or should I fail to take up appointment to the post referred to at para. 1(c) above if offered by the Government, I undertake to refund and repay immediately on demand to the Hong Kong Government all the monies paid to me or expended on my behalf in connection with the said training. ...'

On the same day, the Appellant and Mr A ('the Surety') signed a bond ('the Bond') to the Government to the effect that they were jointly and severally liable for the repayment to the Government of the interest-free loan referred to in subparagraph (e)(i) below.

- (e) On 17 September 1990, the Appellant commenced taking his no-pay leave, which was granted to enable him to pursue the Study Course. In connection with the no-pay leave, approval was given to the Appellant:
  - (i) to receive an interest-free loan equal to his substantive pay for the period of the training payable on a monthly basis; and
  - (ii) to retain his housing benefits by the granting of another interest-free loan equal to home purchase allowance ('HPA') and furniture and domestic appliances allowance ('FDAA') payable on a monthly basis during the no-pay leave period.
- (f) On 6 July 1994, the Appellant was given approval to extend the training course at HKU until September 1994 to enable him to re-sit the PCLL supplementary examination. On 20 July 1994, the Appellant signed another undertaking in connection with the change in the training duration ('the Second Undertaking'). The terms of the Second Undertaking were similar to those extracted in subparagraph (d) above.
- (g) The Appellant completed his training at HKU on 15 September 1994. He proceeded onto his two-year articleship in the Legal Department on 22 September 1994. The period of articleship was subsequently extended for a period of six months from 22 September 1996 to 21 March 1997. As a result of this extension, the Appellant was required to give another undertaking covering the change in the training period ('the Third Undertaking'), the terms of which were similar to those extracted in subparagraph (d) above.

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- (h) (i) Upon completion of the extended period of articleship, the Attorney General notified the Appellant that he was considered not suitable to be offered the appointment as a crown counsel and he was invited to submit representation to this decision.
- (ii) Having considered the Appellant's representation, the Attorney General maintained his decision that the Appellant was not a suitable candidate for appointment to the post of crown counsel. He further advised the Appellant that he would be reverted back to his former post as the senior inspector of police of the Hong Kong Police Force on 22 April 1997 following completion of the Study Course on 21 April 1997.
- (iii) On 22 April 1997, the Appellant commenced his pre-resignation leave and finally ceased his employment with the Government on 10 August 1997.
- (i) During the no-pay leave period, the Appellant received the following amounts of interest-free loans from the Government:

Year of assessment t	Period	Salary loan \$	HPA loan \$	FDAA loan \$	Total \$
1990/91	17-9-1990 – 31-3-1991	184,912	70,902	970	256,784
1991/92	1-4-1991 – 31-3-1992	380,880	165,464	1,800	548,144
1992/93	1-4-1992 – 31-3-1993	423,420	180,000	1,800	605,220
1993/94	1-4-1993 – 31-3-1994	464,760	180,000	1,800	646,560
1994/95	1-4-1994 – 31-3-1995	508,800	180,000	1,800	690,600
1995/96	1-4-1995 – 31-3-1996	559,560	180,000	1,800	741,360
1996/97	1-4-1996 – 31-3-1997	602,520	145,645	1,800	749,965
1997/98	1-4-1997 – 21-4-1997	37,572	-	105	37,677
		3,162,424	1,102,011	11,875	4,276,310

- (j) During the year of assessment 1996/97, the Government waived the repayment of a portion of the salary loan in the amount of \$130,800, which represented the minimum articulated clerk salary received by the Appellant for the period from 19 September 1994 to 31 March 1997 when he took up articulated clerkship upon completion of the PCLL Course.
- (k) On 10 December 1998, the Government informed the Appellant that the repayment of the loans granted to him during the no-pay leave period had been waived.

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- (l) The assessor has assessed the Appellant to salaries tax for the year of assessment 1997/98 on the Sum, which represents \$4,276,310 (subparagraph (i)) - \$130,800 (subparagraph (j)). It is the taxability of this sum that is the subject of the Appellant's appeal to this Board.

### **The relevant provisions of the Inland Revenue Ordinance ('IRO')**

3. For the purposes of this decision, we have considered the following provisions of the IRO: sections 8(1)(a), 9(1)(a), 11B, 11D and 68(4).

### **The case for the Appellant**

4. In his grounds of appeal and written argument presented to us, the Appellant advanced the following arguments:

- (a) The Sum was, and is, still a loan. It has not been waived by the Government and thus cannot be assessed as his income liable to salaries tax.
- (b) In any event, the Sum is not a 'perquisite' within the meaning of section 9(1)(a). Furthermore, the fact that the Government waived his obligation to repay the Sum was not a payment within section 11D(b) and thus the deeming provision in proviso (ii) to that subsection cannot apply.
- (c) The Sum was not a reward for past services. Rather, because he was on no-pay leave during the time that the Sum was loaned to him, he never rendered any service to the Government during or after the period of the training.
- (d) The Government does not have the right to treat the Sum as his taxable income. Its refusal to appoint him as a legal officer was an unconscionable act and whatever rights the Government had to treat the Sum as taxable should not in equity be allowed to be enforced. Furthermore, the Government's right to treat the Sum as taxable income was conditional upon satisfactory completion of his post-training service, and this did not take place.

### **The case for the Commissioner**

5. It is sufficient for present purposes to record that the Commissioner's representative, Ms Ngan Man-kuen, disagreed with each of the Appellant's arguments. In support of her submissions, the Commissioner's representative referred us to the following authorities: David Hardy Glynn v CIR (1990) 3 HKTC 245; BR13/74, IRBRD, vol 1, 159; D83/00, IRBRD, vol 15, 726; D57/92, IRBRD, vol 8, 54; and D19/92, IRBRD, vol 7, 156.

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### Analysis

6. Is the Sum simply a loan that still remains on foot?
- (a) The Appellant based his argument primarily upon the terms of the Bond (referred to at paragraph 2(d)) which states: ‘if the Trainee **continues** in the service of the Hong Kong Government in accordance with the conditions stipulated in [the undertaking] ... then this bond shall be void but otherwise the trainee and the Surety have to repay the amount of loan ...’ (emphasis added). In the Appellant’s view, the Bond is still valid since he did not perform any post-training service.
  - (b) On this basis, the Appellant admitted in argument that the Government still has the right to demand repayment of the Sum, although he demurred when asked during the hearing whether he had offered to repay the Sum (he had not) and whether he would contest any attempt by the Government to recover the Sum (he stated that it would depend upon advice from leading counsel).
  - (c) The Appellant’s argument is contrary to his own submissions to the Government. In his letter to the Director of Accounting Services dated 24 September 1998 (Board’s bundle, page 42) he stated that: ‘Since I have served the Government of the Hong Kong under the conditions of [the Contract], the Bond is void and no repayment of the said loan will be required.’ An exchange of correspondence then followed and, in response to the Appellant’s request for clarification whether the Government accepted that the Bond was void, the Secretary for Justice in a letter dated 10 December 1998 (Board’s bundle, page 36) replied that: ‘The repayment of the salary loan has been waived and therefore, the loan record will be excluded.’
  - (d) We are in no doubt that ‘waived’ means exactly what it says – the Appellant is no longer liable to repay the loan. The Bond, which simply secures the liability of the Appellant and the Surety to repay the loan to the Government, cannot stand after the liability to repay the loan money that it secures has been unambiguously discharged. We therefore conclude that we must decide the taxability of the Sum on the basis that it represents a waiver by the Government of a loan made by it to the Appellant.
  - (e) The Appellant drew our attention to Civil Service Regulations 1010(3) which states: ‘The repayment of any loan granted under CSR 1009 will be waived by the Secretary for the Civil Service **upon completion of satisfactory post-training service** as laid down in CSR 1005’ (emphasis added by the

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Appellant). However, this regulation covers only one instance where the Government ‘will’ waive the loan. We do not see how this regulation can restrict the Government from waiving the loan in other deserving cases (such as in D57/92 cited above, a case relied upon by the Appellant, where the taxpayer through no fault of his own could not complete the course of his studies, and the Government decided that he need not refund the amount of the loan). Although the taxpayer’s appeal was allowed in D57/92 the decision of the Board in that case does not support the Appellant. The appeal in that case was allowed on the basis that the Commissioner had assessed the waiver of the loan in the wrong year of assessment. The Board held in D57/92 at page 62: *‘if this had been a loan which was waived in 1987 as stated by the Commissioner [instead, the Board found that it was waived in an earlier year] then we would have been obliged to uphold the entirety of the assessment’*.

- (f) For the sake of completeness, we have also considered the Appellant’s contention that because the Director of Accounting Services had refused to consider the Sum received during his no-pay leave for the purpose of determining his pension entitlements, it is inconceivable that he should now be taxed on this amount. We reject this argument. How the Sum received during a no-pay period was treated for pension purposes under separate legislation, namely the Pension Benefits Ordinance, is irrelevant to whether the Sum is taxable in accordance with provisions of the IRO.

### 7. Is the Sum a perquisite?

- (a) With due respect to the Appellant, who may have been misled by the Commissioner’s determination, we find it unnecessary to analyse whether the Sum is a perquisite or not. The reason is that the waiver of the loan made to the Appellant by his employer falls simply within the ordinary meaning of income and is liable to salaries tax under section 8(1)(a), provided that it arises from the employment (see D83/00 cited above, a case relied upon by the Appellant).
- (b) For the sake of completeness, we also address the Appellant’s argument on whether the Sum was a perquisite. The Appellant relied upon Glynn’s case (cited above) where Lord Templeman stated at 249 that: *‘A perquisite also includes not only money which is actually paid to an employee but money which is paid in discharge of a debt of the employee.’* The Appellant then argued that it was wrong to equate the granting of a waiver as an act to discharge the debt of the employee due to another person. In our view, however, whether or not the facts of the Appellant’s case can be said to



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involve money paid to discharge his debt to the Government, it is clear that Lord Templeman's judgement did not limit the meaning of perquisite to actual payments of money to an employee and to money paid to discharge the employee's debt to a third party. The use of the word 'includes' makes this crystal clear. Common sense dictates that there should be no difference in tax result where an employer, in accordance with the contract of employment, (1) discharges a debt owed by the employee to a third party (which can clearly be taxable) and (2) waives a debt owed by the employee to the employer itself (which the Appellant claims cannot be taxable). In our view, Lord Templeman's judgement provides no assistance for making such an artificial distinction.

- (c) The Appellant then argued that waiver of the Sum was not a 'payment' within section 11D(b)(ii). The Appellant referred us to the Oxford English Dictionary definition describing 'payment' as 'the action, or an act, of paying'. He contends that there was never any act on the part of the Government to pay anything to him in return for discharging the Sum. We note, however, that the definition goes on to include 'the action, or an act, of discharging an obligation'. This is precisely the case before us. Furthermore, in this case there was a conditional payment when the Sum was advanced (namely payment was conditional upon repayment), but the payment became absolute when the condition was removed by waiver. Indeed, this conclusion accords with the view that the Appellant took in his letter to the Department of Justice dated 24 December 1998 (Board's bundle, page 62). In that letter he contended that: 'the loan has turned into absolute payment when the Government refused to offer an appointment of Government Counsel to me'.
- (d) We note that if our conclusion above were not correct, then D83/00, a case relied upon by the Appellant where a similar training loan to that received by the Appellant was waived by the Government, would have been wrongly decided. In our view D83/00 was correctly decided.
- (e) Finally, it is also not relevant that the Appellant was not 'entitled to claim payment' of the Sum under section 11D(b) because proviso (ii) thereof deems the payment (if taxable) to have accrued to the Appellant on the last day of his employment with the Government.

8. Was the Sum a reward for past services?

- (a) It is generally accepted that, to be liable to salaries tax, income accruing to an employee must be a reward for the provision of services, past, present or future (see Clayton v Gothorp [1971] 2 All ER 1311). Some Board of

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Review cases, however, have taken the view that it is simply sufficient for income to be ‘from the employment’ for section 8(1)(a) to apply and that this provision does not import any necessity for a taxable payment to be a reward for services (see D19/92 cited above). Ms Ngan submitted that we should follow D19/92 in deciding this appeal. For present purposes, however, we are inclined to base our decision upon the more narrow, generally accepted interpretation, which incidentally favours the Appellant.

- (b) The Appellant argues that waiver of the Sum was not a reward for services because, apart from fully completing his period of training, he never rendered any services to the Government during the period of the Study Course because he was on no-pay leave. The Appellant relied on Clayton v Gothorp.
- (c) In Clayton v Gothorp the taxpayer resigned from her job to undertake a period of study for which she received a loan equal to her salary from her former employer. The employer agreed to cancel the loan if she resumed employment after completing the study period and then providing services for no less than 18 months. After she served the 18 months’ period her employer duly discharged the loan. Although Plowman J concluded that the discharge of the loan was a taxable emolument of employment (being a ‘perquisite or profit from employment’ under the relevant United Kingdom legislation) at page 1321 the judge held that ‘... *what turned the loan into an absolute payment was the 18 months’ [post-training] service*’. Since the Appellant did not render any post-training service to the Government, he argued that there was no absolute payment to him and thus he should not be liable to salaries tax on the Sum.
- (d) In response to this argument, we repeat that it conflicts with the Appellant’s submission in his letter to the Department of Justice dated 24 December 1998 (Board’s bundle, page 62) where he stated that: ‘the loan has turned into absolute payment ...’. Furthermore, the facts of Clayton v Gothorp are very different from the facts of the Appellant’s case where, at all times, the Appellant **was** an employee of the Government during the period of the training. The terms under which the Sum was paid to the Appellant make it crystal clear that it was paid for the Appellant undertaking the period of training and that the post-training service was **conditional** upon an offer of appointment being made.
- (e) Although the Appellant was on no-pay leave during this period, we agree with Ms Ngan that the Appellant’s commencement and completion of the Study Course constituted services under his employment with the Government and that what triggered the waiver of the Sum was the fulfilment of all relevant

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contractual conditions on the part of the Appellant. The following facts support this conclusion:

- (i) the no-pay leave counted as pensionable service with the Government (Board's bundle, page 23 paragraph A);
  - (ii) it was stipulated in the Secretary for the Civil Service's letter dated 31 August 1990 to the Appellant (Board's bundle, page 18) that: 'During the summer breaks of the academic part of your training, you will continue to be on no-pay leave and you are required to undergo training attachment in the Legal Department'. During the course of the hearing before us the Appellant admitted that he did perform services for the Government during each summer period covered by the Study Course;
  - (iii) the Appellant had rendered services to the Government under his articulated clerkship during the period 22 September 1994 to 21 March 1997; and
  - (iv) paragraph 6 of each undertaking (see, for example, Board's bundle, page 20) makes clear that the training received by the Appellant is designed to render him 'eligible **for consideration** for appointment to the post of [crown counsel]' (emphasis added).
- (f) In Clayton v Gothorp the loan waived was held to be a reward for past services when the taxpayer had satisfied her contractual obligations to her employer. Similarly, in this appeal, the Appellant completed the Study Course (during which he rendered services to the Government) and then completed his articles with the Attorney-General's Department. There is no evidence before us to suggest that the Appellant had not fulfilled all his contractual obligations to the Government before it decided to waive the loan. It is inconceivable that Government's waiver of the Sum was not a payment for past services. It is not relevant that the Government decided not to appoint the Appellant to the post of crown counsel.

9. Does the Government have the right to treat the Sum as taxable income?

- (a) In essence, the Appellant argues that the Government acted unconscionably in terminating his employment because the parties' mutual intention was that, after completing his training, he would be appointed as crown counsel and serve for a minimum period of five years thereafter. The Appellant further contends that the Government cannot in equity enforce the terms of his undertaking to treat the Sum as taxable income.

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- (b) These arguments fly in the face of all the documents we have before us. These make it abundantly clear that the post of crown counsel would only be ‘offered’ to the Appellant ‘if’ the Government so desired. There was no obligation on the part of the Government to so offer and, in the event, acting within the terms of its contract with the Appellant it did not. We see no merit in these arguments. And even if there were any breach by the Government of the terms of its contract with the Appellant, we cannot see how this could fetter the Commissioner discharging her statutory duty.
- (c) The Appellant also contended that no one had ever explained to him that the Government might not appoint him as crown counsel (he stated that, to his knowledge, it had never happened before), that he did not take legal advice on the terms of the Contract and that he signed the Contract in a hurry. We well understand the Appellant’s obvious disappointment that he did not obtain an appointment. Indeed, from the Appellant’s statements before us we speculate that this may have been an underlying factor behind his determination in pursuing this appeal. But, as stated above, we cannot see how these factors can possibly impact upon whether, as a matter of law, the Commissioner is or is not entitled to treat the Sum as liable to salaries tax in accordance with the provisions of the IRO.

### **Conclusion**

10. In conclusion, it is our view that the Government’s waiver of the Sum constituted income from employment. It was a payment in consideration of the Appellant’s past services. It is thus liable to salaries tax under section 8(1)(a). It has been properly included in his assessable income in accordance with sections 11B and 11D(b)(ii). The appeal is hereby dismissed.