Case No. D1/90

Salaries tax – whether servant allowance, education expenses, bonus and payment of US tax are assessable.

Panel: Robert Wei QC (chairman), William Chan Wai Leung and Chan Pang Fee.

Dates of hearing: 23 and 24 May 1988.
Date of decision: 3 April 1990.

The taxpayer was employed by an overseas church to work in Hong Kong. He received a servant allowance, his children's education expenses, and payment of his US tax whilst he was working in Hong Kong. A bonus also accrued to him but was not payable to him until after he returned to his country of origin.

Held:

The payment of the servant allowance, the children's education expenses, and the US tax were all taxable income of the taxpayer subject to Hong Kong salaries tax. The bonus was taxable because it was earned by the taxpayer when he was in Hong Kong but was not taxable in the year of assessment in question because it was not paid to the taxpayer until a later date.

Case remitted to the Commissioner for revision.

[Editor's note: This case was heard on 23 and 24 May 1988 at which time the Glynn v CIR case was pending before the courts. The decision in this case was deferred pending the ultimate outcome of the Glynn case which was determined by the Privy Council on 22 January 1990.]

Cases referred to:

Glynn v CIR Privy Council Appeal No 23 of [1989]
CIR v Humphrey HKTC 451
CIR v Robert P Burns HKTC 1181

J G A Grady for the Commissioner of Inland Revenue.
Millie Shing of Charles H C Cheung & Co for the taxpayer.

Decision:

1. The Taxpayer is appealing against the salaries tax assessment (as confirmed by the Commissioner of Inland Revenue) for the year of assessment 1984/85 raised on him. He contends that four items of his income are not chargeable to tax.

2. The Taxpayer gave evidence for himself but called no other witnesses. The facts which emerge from his testimony and the documents produced may be summarised as follows:

2.1 The Taxpayer, a missionary of a church in USA ('the Church'), was appointed in 1983 by the Church as its legal representative in Hong Kong with the object of establishing the Church in Hong Kong. By the terms of the employment, the Church was obligated to pay the Taxpayer a salary, a bonus, a servant allowance, his children's education expenses and his US tax. These obligations were duly discharged; in the case of the salary, the servant allowance and the children's education expenses, funds were remitted by the Church from USA to the Taxpayer's personal bank account in Hong Kong to pay them. The bonus was paid to the Taxpayer on his return to USA after the completion of his Hong Kong assignment in 1986, and the US tax was paid in the United States by the Church on the Taxpayer's behalf. The assignment was not of a regional nature but specifically to Hong Kong. Although in the course of the assignment he left Hong Kong occasionally, for example, attending world conference and ministering among the churches in South East Asia at their request, those trips were of an incidental nature.

2.2 Servant allowance Domestic help was provided to the Taxpayer so that he could attend the local language class so as to enable him to preach in the local language.

2.3 Children's education expenses This is a variable expense allowance to overseas personnel in as much as tax supported free public schooling is not available to their children. The amount comprised school fees and fees paid to a private tutor.

2.4 The bonus This represented funds which accrued in the United States and were not payable to the Taxpayer until he returned from his overseas assignment. It was provision set aside for future expenses when the Taxpayer returned to the United States. The bonus funds are credited monthly to a personal account in the name of the Taxpayer and invested collectively in savings or money market funds.

2.5 US tax This is a tax payable by self-employed persons, including church missionaries such as the Taxpayer. In the present case, the Church agreed to and did discharge the Taxpayer's liability by paying the tax for him.

3. The question is whether these four items of income are chargeable to salaries tax.

3.1 Servant allowance It was contended on behalf of the Taxpayer that this item was not taxable because: (a) it was the contractual obligation of the Church to pay for domestic help through the Taxpayer, and as the Church had no bank account in Hong Kong, funds were remitted by the Church from the United States to the Taxpayer's personal bank account in Hong Kong for the purpose of paying, inter alia, for this item, (b) domestic help was provided so that the Taxpayer could attend the language class to enable him to preach in the local language, so the employment of domestic help was for a 'business' purpose, and (c) payments for this item should be allowed as deductions under section 12(1)(a) of the Inland Revenue Ordinance. We do not agree. As for ground (a), we accept that the Church owed the Taxpayer an obligation to pay for domestic help, but it did not owe any similar obligation to the servant. Even assuming that there was a similar obligation owed to the servant, so that payments to the servant were made in discharge of the liability of the Church and not the Taxpayer, that will not help him in view of the recent judgment of the Privy Council in Glynn v CIR, Privy Council Appeal No 23 of 1989, where Lord Templeman says at page 6:

> '… an identifiable sum of money required to be expended by an employer, pursuant to a contract of service for the benefit of the employee, is money paid at the request of the employee and is either part of the employee's salary or is a monetary perquisite taxable as such according to the law and authorities of the United Kingdom. It is money paid at the request of the employee equivalent to money paid to the employee …'

Thus payments made to the servant, being sums of money required to be expended by the Church, pursuant to a contract of service for the benefit of the Taxpayer, is money paid at the request of the Taxpayer and is either part of the Taxpayer's salary or is a monetary perquisite. As for ground (b), we take the view that just because the provision of a domestic help gave the Taxpayer the opportunity of attending the Chinese language class so as to enable him to preach in Chinese, that does not change the fact that wages paid to the servant were monies expended for the Taxpayer's benefit. The payments are part of the income accruing to the Taxpayer from his employment and are therefore assessable to salaries tax under section 11B. Section 11D provides that income accrues to a person when he becomes entitled to claim payment thereof. The Taxpayer was at all times entitled to claim payment of the servant's wages by

the Church pursuant to his contract of service. (See the Glynn case, page 6.) Ground (c) is a claim for a deduction under section 12(1)(a) which was made for the first time at the hearing. Section 12(1)(a) provides that there shall be deducted from the assessable income:

> ' all outgoings and expenses, other than expenses of a domestic or private nature and capital expenditure, wholly, exclusively and necessarily incurred in the production of the assessable income …'

The wages do not qualify for a deduction because: (a) they were expenses of a private and domestic nature, (b) they were not wholly or exclusively incurred in the production of the assessable income, and (c) they were not incurred in the production of the assessable income. (See CIR v Humphrey HKTC 451; CIR v Robert P Burns HKTC 1181.)

3.2 Children's education expenses The Church owed the Taxpayer an obligation to pay both the school fees and the fees of the tutor. However, it was contended for the Taxpayer that an obligation to pay the tutor's fees was also owed by the Church to the tutor and that therefore they were paid in discharge of the Church's liability to the tutor and are not taxable. There is in evidence a written contract made between the Church of Hong Kong, the Hong Kong extension of the Church and the tutor whereby the former employed the latter to teach the Taxpayer's children on the terms and conditions contained therein. We therefore accept that the Church was discharging its own liability to the tutor through the Taxpayer when the fees were paid. But the fees are nevertheless taxable because they were monies expended by the Church pursuant to a contract of service for the benefit of the Taxpayer. (See the Glynn case cited in paragraph 3.1 above.) The same goes for the school fees. Thus this item also falls to be treated as part of the Taxpayer's salary or a perquisite and is taxable accordingly. The Privy Council's judgment in the Glynn case has finally established that money expended for the benefit of an employee by his employer pursuant to the contract of service is taxable, no matter whether the payment discharged the liability of the employee or that of his employer.

3.3 The bonus This item accrued in the United States and was not payable to the Taxpayer until he returned from his overseas assignment. The Taxpayer received his bonus in 1986 when he went back to the United States at the end of his assignment. In our view, this item is part of the Taxpayer's assessable income because: (a) it was money paid to the Taxpayer by virtue of his employment as a missionary in Hong Kong and therefore it was income which accrued to him from that employment within the meaning of section 11B, (b) the fact that it was payable only in the United States and therefore 'accrued' to the Taxpayer, there makes no difference to the assessability of the income, and (c) the fact that it was paid in 1986, that is, at the end of his Hong Kong assignment makes a difference to the year of assessment for the income in that

it falls for assessment in the year of assessment 1986/87 and not in the year of assessment 1984/85.

3.4 US tax This item represents payments made by the Church in discharge of the tax liabilities of the Taxpayer pursuant to the contract service and is a perquisite taxable as such. Lord Templeman says at page 5 of the Glynn case:

> ‘ the result of the authorities is that a perquisite includes money paid to the taxpayer and money expended in discharge of a debt of the taxpayer. There is no difference between a debt of the taxpayer discharged by an employer pursuant to the contract of service and money paid for the benefit of an employee by his employer pursuant to the contract of service.’

Conclusion

4. The bonus is not assessable for the year of assessment 1984/85 and the case is hereby remitted to the Commissioner for revision accordingly; otherwise the assessment in question is hereby confirmed.