Case No. D19/92

Salaries tax – lump sum paid to taxpayer at commencement of employment – whether subject to salaries tax.

Salaries tax – hotel accommodation – whether liable to be assessed to salaries tax.

Panel: William Turnbull (chairman), E M I Packwood and Andrew Wang Wei Hung.

Date of hearing: 14 May 1992.
Date of decision: 31 July 1992.

The taxpayer was employed by an employer in Hong Kong having previously been employed with an associated company in the United Kingdom. The Hong Kong employer paid to the taxpayer a lump sum payment on his joining the employment of the Hong Kong employer. The lump sum payment was a financial inducement to the taxpayer to join the employment of the Hong Kong employer. It was paid to the taxpayer without any obligations regarding its disbursement or any necessity for the taxpayer to account to the Hong Kong employer with regard to how it was spent. However it was calculated with reference to estimated expenses of the taxpayer in relocating himself from the United Kingdom to Hong Kong.

Prior to his being employed in Hong Kong the taxpayer when employed in London had been required to perform some of his duties in Hong Kong and had been provided with hotel accommodation in Hong Kong during that period. He was assessed to tax on a notional sum being the value of quarters provided to him by his employer calculated in accordance with the provisions of the Inland Revenue Ordinance.

The taxpayer objected to the assessment of the lump sum payment and the value of the quarters. With regard to the lump sum payment he submitted that it was not a reward for his services and with regard to the hotel accommodation he submitted that this was a necessary expense which had been borne by customers of his employer.

Held:

The lump sum payment was an inducement to enter into the contract and a relocation allowance. The question to be decided was whether or not the source of the lump sum payment was the employment contract. The Board held that the source was the employment contract and accordingly had been correctly assessed to tax. With regard to the inclusion of the value of the quarters the Board held that

this had been correctly included in accordance with the terms of the Inland Revenue Ordinance.

Appeal dismissed.

Cases referred to:

Hochstrasser v Mayes 38 TC 673
Pritchard v Arundale 47 TC 680
Shilton v Wilmshurst [1991] STC 88
Laidler v Perry 42 TC 351
Hamblett v Godfrey 54 TC 694
D15/77, IRBRD, vol 1, 298
D11/88, IRBRD, vol 3, 191
D13/89, IRBRD, vol 4, 242
CIR v Humphrey 1 HKTC 451
Glantre Engineering Ltd v Goodhand 56 TC 165
Bridges v Bearsley 37 TC 289

Chiu Kwok Kit for Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

This is an appeal by a taxpayer against the inclusion in his income assessable to salaries tax of a lump sum paid to him by his employer at the commencement of his employment. The facts are as follows:

1. The Taxpayer was employed in the United Kingdom in a senior post by a financial company ('the UK employer'). He was approached by another associated financial company in Hong Kong ('the HK employer') which was separate and independent from his UK employer.

2. An employment contract was negotiated between the Taxpayer and the HK employer under which the Taxpayer was entitled to a salary, the provision of residential accommodation, a year end bonus and other benefits. He was employed to be the Managing Director of the HK employer.

3. The terms of his employment contract were contained in a letter dated 28 February 1989 from the HK employer to the Taxpayer which was accepted by the Taxpayer in writing on the same day.

4. The Taxpayer was not prepared to join the employment of the HK employer unless he received a lump sum payment which was to be paid by the HK

employer to the Taxpayer upon his joining the employment of the HK employer. No mention was made of this lump sum payment in the said letter dated 28 February 1989 but this Board finds as a fact that the contractual terms of employment of the Taxpayer included an obligation upon the HK employer to pay such lump sum to the Taxpayer upon his joining the employment of the HK employer.

5. The lump sum payment was US$50,000 which was converted into HK$390,000.

6. There was no obligation placed upon the Taxpayer by the HK employer with regard to how the Taxpayer used the sum of HK$390,000 and the same was paid to the Taxpayer by the HK employer as a lump sum free of all and any obligations. When the lump sum payment was received by the Taxpayer he was free to make use of and/or apply the same for his own use and benefit in any way that he wished.

7. The reason for the lump sum payment was as a financial inducement to the Taxpayer to join the employment of the HK employer. Without this financial inducement the Taxpayer would not have been prepared to give up the senior post which he held in the United Kingdom and the associated prospects of promotion which he then had in the United Kingdom to join the employment of the HK employer in Hong Kong.

8. Though the lump sum was paid to the Taxpayer without any obligations with regard thereto the quantum of the lump sum was negotiated and calculated with reference to what the Taxpayer thought would be the costs of himself and his family moving from the United Kingdom and setting up residence in Hong Kong. It was not an exact sum but was a lump sum, the quantum of which was acceptable to the two parties namely the Taxpayer and the HK employer. So far as the Taxpayer was concerned he estimated that the cost of his moving from the United Kingdom to Hong Kong would exceed the sum of US$50,000 and so far as the HK employer was concerned this was an amount which it was prepared to pay as a lump sum to compensate the Taxpayer for his expenses and to induce him to accept the offer of employment in Hong Kong.

9. The sum of HK$390,000 was paid by the HK employer to the Taxpayer immediately upon his arrival in Hong Kong to take up his employment with the Taxpayer.

10. The Taxpayer in his salaries tax return for the year of assessment 1988/89 stated that his income chargeable to salaries tax included the sum of HK$390,000 stated to be ‘lump sum relocation expenses – inducement’. The assessor raised a salaries tax assessment on the Taxpayer which included the lump sum of HK$390,000. The Taxpayer objected to the assessment on the

ground that the lump sum of HK$390,000 was not liable to be assessed to salaries tax.

11. Prior to the Taxpayer being employed by the HK employer in Hong Kong he had during the year of assessment 1988/89 visited Hong Kong and worked in Hong Kong under the employment contract which he had with his previous employer in the United Kingdom. It was agreed between the Taxpayer and the assessor that during the year of assessment 1988/89 he had spent, including attributable leave, a total of 101.6 days in Hong Kong and that the proportionate amount of his United Kingdom salary attributable to the services which he rendered in Hong Kong was HK$862,572.

12. In due course the matter was referred to the Deputy Commissioner for his determination. He decided that not only was the lump sum payment correctly assessed to salaries tax but also that the sum of HK$862,572 should also be assessed to salaries tax together with an additional notional amount calculated in accordance with the provisions of section 9(1)(b) of the Inland Revenue Ordinance in relation to the hotel accommodation which had been occupied by the Taxpayer when he had been working in Hong Kong for the UK employer. The hotel accommodation had been paid for by the Taxpayer and reimbursed either by the UK employer or the client of the UK employer.

13. The Taxpayer duly appealed to this Board of Review.

At the hearing of the appeal the Taxpayer appeared on his own behalf, made submissions to the Board, and elected to give evidence and be cross-examined. We put on record that the Taxpayer was totally truthful and frank in all of the evidence which he gave to the Board. We have no hesitation in accepting the truth of all of the evidence which he gave before us. The foregoing facts as we have found were a combination of the facts set out in the determination of the Deputy Commissioner, a statement of agreed facts tabled before us and the evidence of the Taxpayer.

The case for the Taxpayer falls into two parts, namely the lump sum payment and the notional value of the hotel accommodation. The Taxpayer submitted that the lump sum was either a relocation allowance to cover part of the expenses which he incurred on behalf of himself and his family to come to Hong Kong or was also an inducement without which he would not have been prepared to leave his employment and to give up his career prospects in the United Kingdom. As we have found as a matter of fact that the lump sum payment was both an inducement and an allowance there is no need for us to further consider this part of the Taxpayer's submission.

The Taxpayer went on to submit that the lump sum payment was not chargeable to tax based on the authority of Hochstrasser v Mayes 38 TC 673. He submitted that the lump sum payment was not a reward for his services. He said that the payment did not arise from his office or his employment and was not a reward for any service which he

may have rendered to the HK employer and that accordingly the payment was not chargeable to tax.

He then referred us to the case of Pritchard v Arundale 47 TC 680. He said that the lump sum payment was similar to the shares which the Taxpayer received in that case and that accordingly the lump sum payment should not be taxable. He submitted that his situation as an employee in the United Kingdom was similar to that of Mr Arundale who was a senior partner in a firm of Chartered Accountants who had family commitments.

The Taxpayer went on to distinguish his case from the recent United Kingdom decision of Shilton v Wilmshurst [1991] STC 88 and also Laidler v Perry 42 TC 351 and Hamblett v Godfrey 54 TC 694.

He made reference to three Board of Review decisions, namely, D15/77, IRBRD, vol 1, 298, D11/88, IRBRD, vol 3, 191 and D13/89, IRBRD, vol 4, 242. He said that they were all cases involving existing employees and were not relevant to his own case. He said that none of them related to inducements made to a person to enter into a contract with an employer.

He went on to cite the case of CIR v Humphrey 1 HKTC 451 which he said was different from his own case because it referred to a mileage allowance.

He then cited Glantre Engineering Ltd v Goodhand 56 TC 165 and submitted that this case was relevant because it related to an inducement paid to a person to join a company as a finance director. However he went on to point out that the Judge in the Glantre case had distinguished it from the Pritchard v Arundale case which he had already cited to us and on which he relied.

The Taxpayer said that the lump sum paid to him was not really in the nature of an allowance paid to him but was in the nature of an inducement to him to join the HK employer in Hong Kong and was compensation for giving up an established position in the UK.

The Taxpayer also cited to us the case of Bridges v Bearsley 37 TC 289, a case in which it was held that the value of certain shares was not taxable as assessable income.

With regard to the second part of his appeal, the Taxpayer made a short and succinct submission which it is convenient to set out in full:

> 'As a result of my frequent short trips to Hong Kong when employed by the UK employer in London I have been assessed to salaries tax for a proportion of my income from the UK employer. As a result of that I have also been assessed for the value of quarters provided as 8% of that amount.
>
> It is quite clear that any expenses incurred on behalf of an employer by an employee and reimbursed by the employer are not assessable on the employee.

> I can also understand that when a Hong Kong employer pays rent for an employee in Hong Kong a proportion of that rent is assessed to salaries tax on the employee.
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> However I find it hard to marry these two concepts to produce the result that an employee of a non-Hong Kong employer who is sent to Hong Kong on business sufficiently frequently to be taxable should also be taxed on part of the hotel bills reimbursed by the employer. In my case during 1988/89 I spent 90 days in Hong Kong consisting of 8 separate visits. On each visit I stayed in a hotel and the bill was reimbursed by (the UK employer) or by the client for whom we were working.
>
> Is it really equitable for any proportion of these bills, however calculated, to be subject to tax on the employee who has no other connection with Hong Kong and whose employer is in the UK?'

The representative for the Commissioner submitted that whether or not a sum is income from employment is a question of fact to be determined by reference to all of the evidence.

He referred us to the decision of Shilton v Wilmshurst [1991] STC 88. He said that the House of Lords had clearly decided in the United Kingdom the meaning of an emolument 'from employment' means an emolument 'from being or becoming an employee'.

He then referred us to Glantre Engineering Ltd v Goodhand and reminded us that it is the words of the relevant statute which must be interpreted and applied and not the words of Judges.

With regard to Laidler v Perry he said that this was the authority for the proposition that a sum can be given to an employee in the hope or expectation that the gift will produce god service in the future and that it is taxable even though it cannot be said to be a reward for something that has not yet been done and may never be done.

He then cited to us the case of Hamblett v Godfrey which held that a payment was taxable even though it was not made in return for the performance of services.

The representative for the Commissioner then referred us to IRBRD D13/89 and drew our attention to the words of Mr Henry LITTON, QC who said in that decision at page 245 that the words of section 9(1) of the Inland Revenue Ordinance are wide and there is no room for the Board of Review to imply some limitation. He also referred us to IRBRD D15/77 and D11/88.

With regard to the second part of the Taxpayer's appeal the representative for the Commissioner drew our attention to the grounds of appeal in which the Taxpayer had made reference to his employment by the HK employer whereas the amount in dispute

related to the time when the Taxpayer was in the employment of the UK employer. He submitted that the amount of the housing allowance had been correctly assessed in accordance with the provisions of the Inland Revenue Ordinance, section 9(2).

This case raises two very interesting and different questions both of which are matters of law as well as of fact. As they are separate and distinct from each other we will deal with them separately in our decision. We first deal with the question of whether or not the lump sum payment is liable to be assessed to salaries tax.

Though the Taxpayer submitted that the essence of the lump sum payment was an inducement to persuade him to enter into the employment of the HK employer, he gave clear and precise and truthful evidence as to the exact nature of this payment. He said that it was both an inducement and an allowance. When addressing us he asked us to decide as a matter of fact that the lump sum payment was either an inducement or an allowance. However with due respect to the Taxpayer we are unable so to do on the basis of his own evidence. The Taxpayer expected to incur expenses to move himself and his family from the United Kingdom to Hong Kong. He expected those expenses would exceed US$50,000 and according to his own calculation made subsequently the expenses of his removal to Hong Kong did exceed US$50,000. Though at the hearing of the appeal the Taxpayer sought to stress the inducement aspect of the lump sum payment, he had made a previous submission to the Commissioner in a letter of 28 March 1990 in which the Taxpayer himself summarized the nature of the payment. After spending some time describing the nature of the significant expenditure which he would have to incur to move to Hong Kong he made the following statement:

> 'As a result in my discussions on terms and conditions with (the HK employer) I insisted on a one-off lump sum payment of HK$390,000 on my arrival to cover such expenses. Without such a payment I would not have accepted his offer.'

From this simple statement, which is consistent with all of the other evidence before us, it is not possible for us to find as a fact anything other than that the lump sum payment was a payment made by the HK employer to recompense the Taxpayer at least in part for the removal expenses which he would incur in coming to Hong Kong, and that such payment was also an inducement without which the Taxpayer would not have come to work in Hong Kong.

Though we have made this finding of fact it is not an end of the matter either in favour of the Taxpayer or the Commissioner. It simply clears the field and enables us to concentrate on the question which is whether the lump sum payment, being both a relocation allowance and an inducement to enter into a contract is subject to the charge to salaries tax contained in section 8 of the Inland Revenue Ordinance.

Many cases were cited to us by the parties who sought to rely on those which favoured them and to distinguish those which appeared to be against them. With the exception of the three Hong Kong Board of Review Decisions and CIR v Humphrey, all of

the cases cited before us were United Kingdom tax cases. United Kingdom tax law is very significantly different from that of Hong Kong. In Hong Kong we have a system of taxation based upon various charges to tax, one of which is salaries tax. The United Kingdom has a more comprehensive system of taxation. Though it may be possible to draw threads of principle from the United Kingdom cases, it is necessary very carefully to analyse each and every one to see whether or not the threads of principle are based upon United Kingdom tax concepts which are foreign to our system of tax law. We take the view in this case that it is both unwise and unnecessary for us to embark upon a detailed review of the United Kingdom authorities which were cited to us. By way of example we refer to Shilton v Wilmshurst which is the latest United Kingdom case and was decided by the House of Lords. It was common ground in that case that the sum of 75,000 pounds paid by Nottingham Forest to the taxpayer was an emolument as defined by section 183 of the United Kingdom Act. What was in dispute was whether or not the payment of 75,000 pounds was also taxable under section 181 of the United Kingdom Act. With due respect none of this has any relevance to Hong Kong because the question which we must decide had been conceded by the parties under United Kingdom tax law.

The Hong Kong cases are also of limited help. IRBRD D15/77 related to whether or not a government employee was taxable on an overseas education allowance, D11/88 related to a removal allowance paid to a government employee during the course of his employment, and D13/89 also related to a removal allowance paid to a government employee. CIR v Humphrey was a case relating to whether or not a government servant should be taxed on motor car expenses. All four of these Hong Kong Decisions are substantially different from the question which we now have to consider and decide.

The starting point in any salaries tax matter must be section 8 of the Inland Revenue Ordinance. Sub-section (1) states that 'salaries tax shall … be charged … on every person in respect of his income … from … any office or employment of profit.' These are the words which impose the charge of salaries tax. The question can then be simply stated. We must decide whether or not the lump sum payment was part of the income of the Taxpayer from his employment with the HK employer.

The heading to section 9 of the Inland Revenue Ordinance reads 'definition of income from employment' but this heading is a little misleading because the opening sub-section (1) states that 'income from any office or employment includes'. Section 9 is not an exhaustive definition but merely a list of items which are included. Though it appears clear to us that the lump sum payment can be described as either a 'perquisite' or 'allowance', both being words contained in section 9(1)(a) this is also of little help. Allowance means a sum of money allotted or granted for a particular purpose such as expenses and a perquisite is a little more complex meaning an incidental emolument, fee, or profit over and above fixed income, salary, or wages or alternatively any bonus or fringe benefit granted to an employee. On the facts which we have found the lump sum payment is closer in meaning to an allowance but as the same was paid to the Taxpayer free and clear of any obligations as to how it was to be expended it could also come within the meaning of perquisite. However, as we have said, this does not answer the question before us. The fact that the lump sum payment was a perquisite or allowance or indeed any other form of

income does not answer the question whether or not its source was the employment of the Taxpayer with the Hong Kong employer. That is what section 8 says it must be if it is to come within the charge of salaries tax.

The source of something is a matter of fact and not of law. A careful analysis of the facts before us leads us to the conclusion that the source of the lump sum payment was the employment of the Taxpayer with the HK employer. Indeed it could be nothing else. It was not a payment made to the Taxpayer unrelated to his employment and it certainly was not a gift. It was not a payment made some time before his employment and unrelated to his employment. It was a front end payment but was an integral part of his employment and indeed part of his employment contract. There is nothing in sections 8 or 9 of the Inland Revenue Ordinance which limit taxable payments to remuneration for services rendered or to be rendered. Section 8 relates to income from a source namely the employment. This lump sum payment was part and parcel directly from the employment which the HK employer offered to the Taxpayer and which the Taxpayer accepted. Accordingly it is assessable to salaries tax.

The second question which we have to decide is also very interesting and is totally unrelated to the first question. Like many other persons the Taxpayer at that time was employed by an overseas employer under an overseas contract to work outside of Hong Kong. It is quite clear and obvious that the employment of the Taxpayer with the UK employer was not a Hong Kong employment. The source of his income was outside of Hong Kong and did not arise in nor was it derived from Hong Kong. However section 8(1A)(a) of the Inland Revenue Ordinance includes within the charge of salaries tax all income derived from services rendered in Hong Kong including leave pay attributable to such services. This sub-paragraph brings within the charge of salaries tax monies which are earned by a person under an overseas employment contract where such services are actually performed in Hong Kong. It is the converse to the next two sub-paragraphs which exclude income derived from services rendered outside of Hong Kong.

So far as we are aware few cases such as the present one come up for consideration. Because of our territorial tax system it is both right and proper that any person who comes to Hong Kong and performs services should be subject to Hong Kong tax on that part of his income which is attributable to the services which he renders in Hong Kong. However it would clearly damage our economy and image as an international centre if everyone who did a day's work in Hong Kong found himself liable to be assessed to salaries tax on a proportion of his income. To avoid this, section 8(1A)(a) is made expressly subject to paragraph (b) and (1B) thereof the effect of which is to ignore any visits to Hong Kong not exceeding a total of 60 days.

In the present case the Taxpayer spent more than sixty days in Hong Kong so that he is assessable to salaries tax on that part of his income which was derived from the services which he rendered in Hong Kong. Once the liability to be assessed has been established, then there is no difference between a person employed inside or outside of Hong Kong so far as the method of calculating the income is concerned. Section 9 is of universal application. Accordingly, as night follows day so it is inevitable that if the

employer provided the Taxpayer with a place of residence either rent free or at a subsidised rent then the Taxpayer is liable to be assessed on the rental value of such place of residence as calculated according to the Inland Revenue Ordinance (section 9(1)(B), 9(1)(C) and 9(2)). That a room in a hotel is a place of residence cannot be disputed and is expressly covered by the proviso to section 9(2). The Taxpayer pointed out to us that there was no advantage to him because he was required to pay the cost of the hotel room and the sum was then reimbursed either by his UK employer or by the client of the UK employer. No doubt the Taxpayer continued to maintain his home in the United Kingdom and pay all associated expenses so that there was no financial benefit to him in having available the use of a hotel room in Hong Kong. However our law of taxation is quite clear and precise. There is no exemption for an overseas employee whose employment is not a Hong Kong source employment but who performs services in Hong Kong. Maybe, as the Taxpayer submitted, it is not equitable for an overseas employee to be subject to Hong Kong tax on the cost to his employer of a hotel room in Hong Kong. Maybe it is not equitable to pay tax on something which is no more than the reimbursement of an expense which would not have arisen if the Taxpayer had not come to Hong Kong. However that is what our law says and as we know so well equity has little or no room in taxation matters. Accordingly we are obliged also to dismiss the appeal of the Taxpayer on this second point.

For the reasons given we dismiss this appeal, confirm the determination of the Deputy Commissioner dated 4 March 1992 and order that the salaries tax assessment for the year of assessment 1988/89 dated 7 March 1990 showing net chargeable income of HK$558,564 with tax payable thereon of HK$86,577 be increased to net chargeable income of HK$1,479,921 with tax payable thereon of HK$229,387.