INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D21/00

Salaries tax – holiday allowance – whether exempt from salaries tax as being ' holiday warrant or passage' under section 9(1)(a) of the Inland Revenue Ordinance (' IRO').

Panel: Andrew Halkyard (chairman), Chua Guan Hock and Jiang Zhaodong.

Date of hearing: 5 April 2000.
Date of decision: 13 June 2000.

At the beginning of the year of assessment 1997/98, the taxpayer' s remuneration from his employment was changed from 100% salary to 90% salary and 10% holiday allowance. The Revenue argued that the holiday allowance was part and parcel of salary and that the mere reclassification of salary did not alter the real picture. Further, splitting and labelling a payment was not conclusive.

Held by the Board :

1. The terms of the taxpayer' s contract were actually changed. It was not simply a re-labelling of the said remuneration. As of 1 April 1997 his salary comprised two components (salary and holiday allowance) and not just salary: D34/96 distinguished;

2. Holiday allowance was an additional benefit – not in the form of remuneration but one that was tax-advantaged to the extent that the taxpayer was able to utilise it. This benefit was clearly ' for the purchase of any such holiday warrant or passage' within section 9(1)(a)(ii) of the IRO;

3. The exemption was only available if the taxpayer actually took the holidays and incurred the holiday expense. If he did not take the holiday, no such exemption was available.

Appeal allowed.

Cases referred to:

D8/82, IRBRD, vol 2, 8
D34/96, IRBRD, vol 11, 497
D2/99, IRBRD, vol 14, 84
D19/95, IRBRD, vol 10, 157

Wong Yu Sui Ying for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal against salaries tax assessments raised on the Taxpayer for the years of assessment 1997/98 and 1998/99. The Taxpayer claims that certain holiday allowances received by him from his employer are not liable to salaries tax.

The facts

2. The agreed facts, which we so find, are set out in the Commissioner' s determination. Those facts are as follows:

1. The Taxpayer commenced his employment with a company (' the Employer') on 8 June 1992.

2. The employer' s returns filed by the Employer in respect of the Taxpayer for the years of assessment 1997/98 and 1998/99 disclosed the following particulars:

Period of employment	1-4-1997 to 31-3-1998	1-4-1998 to 31-3-1999
Capacity in which employed	Assistant manager of accounts department	
Income	$	$
Salary	237,218	237,218
Holiday allowances	26,357	26,357
	263,575	263,575

3. In his tax returns for the years of assessment 1997/98 and 1998/99, the Taxpayer declared the same income particulars reported by the Employer at fact 2. He also claimed the following holiday expenses should be deducted against the holiday allowances:

Year of assessment 1997/98

Travellers	**Period**	**Destination**	**Description**	**Amount**
				$
The Taxpayer and his wife	16-3-1998 to 19-3-1998	USA	Air tickets, HK airport tax and hotel accommodation	9,340
The Taxpayer, his wife and son	21-3-1998 to 22-3-1998	Macau	Ticket and hotel accommodation	1,408
				10,748

Year of assessment 1998/99

Travellers	**Period**	**Destination**	**Description**	**Amount**
				$
The Taxpayer, his wife and son	29-8-1998 to 30-8-1998	Macau	Ferry tickets and hotel accommodation	1,475
The Taxpayer, his wife and son	10-3-1999 to 18-3-1999	Canada	Air tickets	10,200
				11,675

4. The assessor did not allow the claimed holiday allowance to be deducted and assessed the Taxpayer's income liable to salaries tax as being the total amounts disclosed at fact 2.

5. The Taxpayer objected to the assessments and claimed that the holiday expenses disclosed at fact 3 should not be liable to salaries tax.

6. In correspondence with the assessor, the Employer stated that:

(a) Staff salary was paid monthly in arrears. The Taxpayer also received an end-of-year double payment for December.

(b) With effect from 1 April 1997, 10% of local staff's annual salary was treated as holiday allowances regardless of whether any trips were made.

(c) The Taxpayer's holiday allowances disclosed at fact 2 were calculated as follows: $20,275 (basic monthly salary) x 13 x 10% = $26,357.

(d) The Taxpayer was free to spend the holiday allowance (which was paid to him as a cash allowance) and he was not required to produce documentary evidence in order to claim the allowance.

7. The Commissioner rejected the Taxpayer's objection. She stated that:

> ' The holiday allowances were reclassified as such for 10% of the total salaries paid to the Taxpayer for the years concerned. Such reclassification would not change the nature of the receipts from being income from employment. The Employer has confirmed that the holiday allowances were paid to the Taxpayer regardless of whether any trips were taken by the Taxpayer. In the circumstances, the holiday allowances cannot be regarded as "holiday warrant or passage" granted to the Taxpayer which were to be exempted by virtue of section 9(1)(a) of the Ordinance. Rather, the holiday allowances were part of the remuneration paid to the Taxpayer and have been correctly assessed to salaries tax.'

The hearing before us

8. The Taxpayer gave sworn evidence before us. We found him to be a competent witness. On the basis of that evidence and the documents produced to us at the hearing by the Revenue, we find the following additional facts:

(a) Initially, the Taxpayer's contract of employment with the Employer did not provide that he would be paid any amount as ' holiday allowances' . Article 10 of the Employer's Regulations, which was incorporated into the contract, provided:

> ' Every year, the [Employer] will adjust the wages according to performance appraisals of the staff members and the price index. The wage adjustment will be made at the end of February annually.'

(b) In February 1997 the Taxpayer's salary was not adjusted as per fact 8. The Taxpayer discussed this matter with the Employer's chairman and, given that he would receive no pay rise for the coming year, suggested that the Employer change the conditions of employment so that he was paid part of his remuneration by way of holiday allowance. The Employer agreed. This change was made with effect from 1 April 1997.

(c) As a result of the change, the Taxpayer did not receive any additional cash payment. He agreed that his post-March 1997 salary was simply split into two components, namely, salary and holiday allowance.

(d) The trips referred to at fact 3 were for holidays. There is no dispute between the parties that the expenditure claimed by the Taxpayer for those trips was incurred by him.

(e) At all relevant times, the Taxpayer owned a flat in Hong Kong. He therefore did not require, nor receive, any rental benefit from the Employer.

The statutory provisions

9. Section 8(1) of the IRO provides that salaries tax shall be charged on income from employment. Income from employment is defined in section 9(1) to include salary, perquisite or allowance. Notwithstanding that cash allowances are generally taxable under these provisions, a specific exemption from salaries tax appears in section 9(1)(a) as follows:

> *'9(1) Income from any office or employment includes –*
>
> *(a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite or allowance, whether derived from the employer or others, except –*
>
> *(i) the value of any holiday warrant or passage granted by an employer to an employee in so far as it is used for travel;*
>
> *(ii) any allowance for the purchase of any such holiday warrant or passage in so far as it is expended for that purpose;*
>
> *(iii) …'*

The contentions of both parties

10. The Taxpayer's argument was straightforward and simple. Relying upon the Employer's statements to the assessor as well as his own testimony, he contended that his contract of employment changed from its original terms and that with effect from 1 April 1997 he was entitled to and was paid a holiday allowance. To the extent that he expended certain amounts of this allowance for holiday travel, those amounts should not be subject to salaries tax.

11. Mrs Wong Yu Sui-ying represented the Commissioner. Mrs Wong argued that splitting and labelling a payment is not conclusive (see D8/82, IRBRD, vol 2, 8; D34/96, IRBRD, vol 11, 497; D2/99, IRBRD, vol 14, 84). Mrs Wong contended that the Taxpayer and the

Employer had merely reclassified the Taxpayer's remuneration and that the so-called 'holiday allowances' were simply part and parcel of his salary. Put another way, the Taxpayer's remuneration from employment ($20,275 x 13: fact 6(c)) was exactly the same immediately before and immediately after 1 April 1997, regardless of whether the Taxpayer incurred any expenses for holiday travel. In conclusion, Mrs Wong argued the Taxpayer and the Employer split the remuneration into two parts and that the real nature of the so-called holiday allowances was, from beginning to end, salary.

12. Finally, Mrs Wong argued that, if we found the Employer provided holiday allowances to the Taxpayer, then they were not 'for the purchase of any such holiday warrant or passage' within the terms of section 9(1)(a)(ii).

Analysis

13. We agree with Mrs Wong that splitting and labelling of a payment is not conclusive of taxation treatment in considering whether that payment is liable to salaries tax. But we disagree with Mrs Wong that this appeal can be decided on this ground alone. In D34/96, relied upon by Mrs Wong, the Board of Review stated at page 502:

> '*Conversely, if the Taxpayer did not incur any rental expenses and thus produced no rental receipts, he would still be paid the same amount. This is not a case of two parties agreeing on an employment package comprising of two different components, one being rent refund and the other being commission. This is a case of two parties agreeing on an employment package comprising of only one component, namely commission and then agreeing at the end of the year, depending on the commission earned, to label part of that component rent refund and the balance commission. In fact, the whole amount was, from beginning to end, commission earned based on an agreed percentage or a commission pay-out scale.*' (emphasis added)

14. In the present appeal, unlike D34/96, the Taxpayer's evidence, which we have accepted and which was not seriously challenged in cross examination, was that the terms of his employment contract were changed. Thus, although the amount of his take-home pay remained the same, with effect from 1 April 1997 his remuneration comprised two components, namely, salary and holiday allowance and not salary alone.

15. We appreciate that the Employer has made a seemingly contradictory statement to the assessor at fact 6(c). The Employer stated that the Taxpayer's 'basic monthly salary' was $20,275, which when multiplied by 13 months gives the Taxpayer's total remuneration for the year of $263,575. In our view however the preponderance of evidence is, and we so find, that the amount of $20,275, being the monthly cash payment made to the Taxpayer by the Employer, consisted of both salary and holiday allowance components.

16. At one point in argument, Mrs Wong contended that the amounts in dispute were cash allowances subject to salaries tax because the Employer did not exercise any control over the way in which they were expended (see D19/95, IRBRD, vol 10, 157). This argument was abandoned (in our view properly) when it was clear that the case law on which it depended, which concerned the issue of ' rental refund', dealt with statutory wording very different from that used in section 9(1)(a)(ii). We should add however that, as developed by Mrs Wong, the argument might help to determine whether the allowance was indeed ' for the purchase of any …holiday warrant or passage' within the terms of that provision. But, of itself, the absence of employer control over the way it is spent cannot be conclusive.

17. We must now decide whether the amount designated by both the Employer and the Taxpayer as ' holiday allowance' and actually expended on holiday travel is exempt from salaries tax under section 9(1)(a)(ii).

18. As indicated above, Mrs Wong did not feel justified to press the argument that the payment could not be categorised as a ' holiday allowance' simply because the Employer did not exercise control over whether the Taxpayer spent the allowance on holiday travel. We agree. Mrs Wong did, however, argue that because the Employer was not concerned how the allowance was spent, the allowance was not paid ' for the purchase of any such holiday warrant or passage' within section 9(1)(a)(ii).

19. Specifically, Mrs Wong argued that the allowance could not be said to be paid to the Taxpayer with the object, intent or purpose of purchasing any holiday warrant or passage if the Employer had not asked the Taxpayer to produce any documentary evidence to prove its expenditure. In other words, Mrs Wong stated that the holiday allowance was simply a cash allowance over which the Taxpayer was free to spend irrespective of whether, and to what extent, he expended it.

20. We appreciate that the Taxpayer could spend the allowance in whatever way he wished. But this does not alter the fact that both the Taxpayer and the Employer specifically agreed to alter the terms of the Taxpayer' s contract of employment to provide him with a specific and additional benefit – not in the form of increased remuneration, but one that was tax-advantaged to the extent that the Taxpayer was able to utilise it. Was this benefit, designated by both parties as a holiday allowance, ' for the purchase of any such holiday warrant or passage' within the terms of section 9(1)(a)(ii)? On the basis of the evidence adduced at the Board hearing, and the facts found by us showing the variation by consent of the Taxpayer' s contract of employment, we conclude that it was for that purpose.

21. We note that the IRO does not state that a holiday allowance for that purpose must be exempt from salaries tax. For instance, if the Taxpayer was too busy, or had some other personal reason not to take holidays, then no exemption would be available. The statutory exemption

contained in section 9(1)(a)(ii) would simply not be satisfied in this case. In this regard, the actual use of the allowance for holiday travel by the Taxpayer is of no concern to the Employer. This may explain the Employer's statement to the assessor per fact 6(b) that 'It is the policy of the [Employer] …that with effect from 1 April 1997, 10% of salary is treated as holiday allowances regardless whether the trips were made.' But, to the extent that the Taxpayer did take holidays and did incur holiday travel expenses not exceeding the amount of the holiday allowances specifically granted to him as an additional employment benefit, this is precisely the situation for which salaries tax exemption is allowed under section 9(1)(a)(ii).

22. For all the above reasons we allow this appeal and order that the amounts of $10,748 and $11,675 respectively be excluded from the salaries tax assessments raised on the Taxpayer for the years of assessment 1997/98 and 1998/99.