

Case No. D21/09

Salaries tax – discretionary bonus payment on termination of employment – whether compensation or employment income – sections 8(1), 9(1)(a), 66(1A) and 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Colin Cohen (chairman), Leung Hing Fung and Chris Mong Chan.

Date of hearing: 18 June 2009.

Date of decision: 28 July 2009.

The Taxpayer applied for an extension of time to file her Notice of Appeal. She explained that during the notice period, she had been exceptionally busy looking after her daughter who had suffered an accident.

The Taxpayer contended that the discretionary bonus of \$345,000 paid to her by her ex-employer, Company A upon termination was a compensation for her loss of employment, a payment for her to remain quiet and not to institute proceedings against Company A for wrongful dismissal and hence not chargeable to salaries tax.

Held:

1. The Board granted an extension of time to the Taxpayer to file her appeal out of time pursuant to section 66(1A).
2. The termination letter and the Schedule clearly show that the intention of Company A was to pay a sum of \$345,000 to the Taxpayer in connection with the Taxpayer's past services. The Taxpayer also signed a memorandum confirming that this was correct.
3. There was no evidence at all to show that Company A was in breach of its contractual obligations and that the Taxpayer would be entitled to receive any compensation.
4. There was also no evidence in support of the Taxpayer's proposition that the sum of \$345,000 paid to her was a payment for the loss of her rights in respect of taking any legal action against Company A.

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Appeal dismissed.

Cases referred to:

- D80/00, IRBRD, vol 15, 715
- D87/01, IRBRD, vol 16, 725
- D4/05, (2005-06) IRBRD, vol 20, 256

Taxpayer in person.

Wong Ka Yee and Chan Wai Yee for the Commissioner of Inland Revenue.

Decision:

1. The Taxpayer has appealed against the Determination dated 25 February 2009 by the Deputy Commissioner of Inland Revenue (‘the Deputy Commissioner’) in respect of an additional salaries tax return for the year of assessment 2006/07.
2. The issue to be dealt with by the Board is whether the sum of \$345,000 which was paid to the Taxpayer by her ex-employer, Company A is chargeable to salaries tax.

Late appeal

3. On 25 February 2009, the Determination was signed by the Deputy Commissioner. The Determination was delivered to the Taxpayer by registered post and was collected from the post office on 9 March 2009. The Taxpayer, however, filed a Notice of Appeal dated 6 April 2009 that was ultimately received by the Clerk to the Board of Review on 7 April 2009. Hence, pursuant to section 66(1) of the Inland Revenue Ordinance (‘IRO’), the Taxpayer applied for an extension of time in which to file her Notice of Appeal. The Taxpayer informed us that her daughter suffered an accident in March and she was exceptionally busy looking after her daughter and dealing with all her other personal matters. In the light of her explanation, we accepted that there was a reasonable cause preventing her from filing the appeal within time. We therefore were prepared to grant her an extension to file her appeal out of time pursuant to section 66(1A), which we now do so.
4. The Taxpayer gave evidence and informed us that she was employed by Company A as a Managing Editor at a starting salary of \$115,000 per month. She confirmed that she commenced employment on 12 December 2005. She informed us that she was appointed to a senior position within the management structure of Company A. A letter dated 21 November 2005

set out her terms of employment. Her employment included the following terms:

Discretionary Bonus

You may be eligible for an annual bonus. Whether a bonus is to be paid to an individual and the amount of that bonus, if payable, will be determined by the Company at its sole discretion by reference to that individual employee's performance and the Company's financial performance. The fact that one individual employee is awarded a bonus does not confer any right or entitlement to a bonus on the part of another employee.

You shall not be eligible for an annual bonus if you have terminated your employment or have served notice to terminate your employment with the Company, or if the Company has dismissed you or given notice to dismiss you at the time when the Company decides upon whether or not to award an annual bonus.

.....

Termination of Service

Your employment may be terminated by three months' notice in writing given by you or the Company or a payment in lieu of such notice. The Company may terminate your employment forthwith by notice in writing in any case of conduct by you justifying summary dismissal.'

5. The Taxpayer drew to our attention that she was previously headhunted to take up this position with Company A. She initially reported directly to the Chairman of Company A and thereafter, reported to the Editor in Chief. She advised us that she believed that her employment contract did not reflect all the duties she was obliged to carry out. In particular, she indicated that as the Managing Editor, she was involved in dealing with regulatory compliance in respect of internal staff issues. She was involved with general corporate governance with regard to the Editorial Team. She also drew to our attention the various issues which she said she had to deal with during 2006. In particular, there were various problems she drew to our attention at Company A with regard to various staffing problems.

6. On 31 January 2007, she received a letter terminating her employment. The letter stated the following:

'This is to acknowledge your resignation from (Company A).

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As agreed between you and Management, your last working day will be 31 January 2007 In accordance with the terms of your employment, the company will pay you three months' payment in lieu of notice. In recognition of your contribution to the Company in the past, the Management has approved that a discretionary bonus to be paid to you

7. On the same date, she also received a notice entitled 'Final Payment on Employee' s Cessation of Service'. That set out the following items:

Payment in Lieu of Notice	(3 months)	\$345,000.00
Unused Leave	(6 days)	\$ 31,363.64
2006 Discretionary Bonus	(3 months)	<u>\$345,000.00</u>
		<u>\$721,363.64</u>

8. On the same date, she signed an acknowledgement of receipt of the relevant sums that she was to be paid within the next seven days.

9. She told us that her termination of employment came as a complete surprise to her. On 26 January 2007, she received a call from the secretary to the Chairman to meet with him. At that meeting, he indicated that there was no longer a position for her at Company A and that her last day would be on 31 January 2007. There was some discussion as to whether or not there could be any other opportunities for her but she was told that they would not be prepared to offer any similar post and in turn, she was advised that she needed to talk directly with the Human Resources. The Chairman did indicate that any payments to be made to her would need to be considered by the Remuneration Committee but she was given an indication that a 6-month sum might be made available.

10. Thereafter, the Taxpayer dealt directly with Ms B, the Director of Human Resources Department. A meeting with her was held on 31 January 2007. At that meeting, she was provided with a notice indicating the sums that she would receive on cessation of her employment and in turn, she confirmed her acceptance by signing on the relevant form. However, she indicated to us that she believed she had no alternative but to sign the form otherwise, she would not receive any payment. She told us that the sum of \$345,000 in lieu of notice and a further sum of \$345,000 by way of discretionary bonus were acceptable to her. In short, she was content with the sums received. She also received her unused leave which was due to her in the sum of \$31,363.64.

11. She indicated to us that she did receive the final payment from Company A and shortly afterwards, obtained new employment with another company.

12. Thereafter, she entered into extensive discussions and communications and correspondence with the Inland Revenue Department as to whether the sum of \$345,000 in respect of the 2006 discretionary bonus was taxable. In short, her position before the Board all

along was that the sum received was a compensation for her loss of employment and that since she held a senior position, it was inevitable that this must have been a payment for her to remain quiet and not to institute proceedings against Company A for wrongful dismissal. She was of the view that this was a payment for her goodwill.

The relevant legislation

13. Section 8(1) of the IRO is the basic charging section for salaries tax. This section reads as follows:

‘Salaries tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from the following sources-

(a) any office or employment of profit;’

14. Section 9(1)(a) of the IRO provides a non-exhaustive definition of the term ‘income from employment’ and states as follows:

‘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,’

Burden of proof

15. In relation to burden of proof, section 68(4) of the IRO provides as follows:

‘The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.’

The relevant legal principles

16. A sum is chargeable to salaries tax if it is income from employment of profit within the meaning of section 8(1) of the IRO. We accept that for a sum to be compensation, it must be shown that there is a loss or surrender of rights on the part of an employee and a legal liability on the part of an employer to pay compensation for the loss of rights. Our attention was drawn to the following authorities which clearly reflect the above:

(a) D80/00, IRBRD, vol 15, 715;

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- (b) D87/01, IRBRD, Vol 16, 725; and
- (c) D4/05, (2005-06) IRBRD, vol 20, 256.

Our analysis

17. In our view, it is clear that the Taxpayer was employed by Company A under written agreement. The terms of the written agreement clearly set out the various provisions with regard to termination. Under the terms of her employment, she received a salary in lieu of notice (3 months' salary) and a further sum of \$345,000 by way of discretionary bonus. The Taxpayer submitted before us that the sum that she received was not a bonus for services rendered by her in the past. We have no difficulties in rejecting such a contention. The termination letter dated 31 January 2007 stated as follows:

'..... In recognition of your contribution to the Company in the past, the Management has approved that a discretionary bonus to be paid to you

18. The Schedule also clearly stated that this sum was a discretionary bonus. The termination letter and the Schedule clearly show that the intention of Company A was to pay a sum of \$345,000 to the Taxpayer in connection with the Taxpayer's past services.

19. The Taxpayer signed a memorandum confirming that this was correct. We reject the submissions and indeed, the evidence put to us by the Taxpayer that this sum was not a bonus but in essence was a payment to her by way of compensation. She adduced no evidence nor drew to our attention any documents nor did she call any evidence to support such a proposition. Again, we have no hesitation in concluding that the sum she received was in a nature of an award for her past services and as such, was income from her employment. There was no evidence at all to show that Company A was in breach of its contractual obligations and that she would be entitled to receive any compensation. Indeed, her employment was not for a fixed term. She was given notice in accordance with the terms of her contract. Again, we accept that there was no evidence to show that the Taxpayer surrendered any rights in consideration for accepting the sum of \$345,000. The Taxpayer was not entitled to any long service payment or any severance payment since she had worked with Company A for a period of less than two years.

20. During the course of her submissions, the Taxpayer indicated to us that the sum paid to her was compensation for the loss of her rights in respect of taking any legal action. Again, no evidence was called to support such a proposition nor was she able to draw any documents to our attention to show that this indeed was the case.

21. We have carefully reviewed all the evidence and listened very carefully to the Taxpayer's submissions and read all the relevant documents which she had previously sent to the Board.

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22. We have come to a conclusion that it is clear that the Taxpayer has not persuaded us that the sum of \$345,000 is not income from employment with Company A and should not be chargeable to salaries tax. We have no hesitation in concluding that the sum she received indeed arose from her employment with Company A in the nature of a reward for services and was not compensatory in nature. Therefore, we have no hesitation in concluding that the sum was correctly assessable to salaries tax.

23. We have no hesitation in dismissing this appeal and upholding the relevant assessment for the year 2006/07.