Case No. D25/99

Salaries Tax – income – severance payments and long service payments – sections 8 and 9(1)(a) of the Inland Revenue Ordinance – sections 31B(2), 31J(2), 31R, 31T(1) and 31T(2) of the Employment Ordinance.

Panel: Anna Chow Suk Han (chairman), Herbert Liang Hin Ying and Stephen Yam Chi Ming.

Date of hearing: 12 February 1999.
Date of decision: 16 June 1999.

The taxpayer was an employee of Company X which was restructured during the year of assessment in which the taxpayer's salaries tax was assessed. The shareholding of Company X was changed but Company X's operation and structure remained the same. Company X paid a sum of $55,460 to the taxpayer as long service payments accrued prior to the restructure. After the payment of the sum, the taxpayer was re-employed by Company X on employment terms substantially the same as those of the previous one.

The taxpayer raised objection to the assessor's assessment by reason that the sum of $55,460 was severance payment and was therefore wrongly included in the assessment. The Commissioner overruled the taxpayer's objection and the notice of determination was given to the taxpayer on 8 October 1998. By a letter dated 10 November 1998 the taxpayer gave notice of his appeal against the determination.

Held:

(1) It has been an established practice that the Inland Revenue Department does not tax severance payments and long service payments which are made under and by reason of the IRO. The Inland Revenue Department considers that these payments are compensation for loss of employment, thus not constituting income from employment within the meaning of section 8 of the IRO.

(2) The existence of Company X, a limited company, was in no way affected by its change of shareholders. It had remained one and the same legal entity despite its change of shareholders, thus one and the same employer to the taxpayer.

(3) Assuming that the taxpayer was dismissed within the meaning of section 31T(1) of the Employment Ordinance, still he could not have been entitled to a long service payment by reason of section 31T(2), since the taxpayer was

immediately re-engaged by Company X after termination of his previous contract.

(4) Although the taxpayer was in Hong Kong for the early part of the statutory one month period, his unexpected trip to China was a reasonable cause which prevented him from giving the notice within the specified time.

Appeal dismissed.

Cheung Mei Fan for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The appeal

1. This is an appeal by the Taxpayer against the determination by the Commissioner of Inland Revenue dated 8 October 1998. In that determination, the Commissioner overruled the Taxpayer's objection in respect of a sum of $55,460 raised in his salaries tax assessment for the year of assessment 1995/96. That sum of $55,460 was part of a total amount of $198,998 which the Taxpayer received from his employer, a company named Company X during the period between 1 April 1995 and 31 March 1996.

The Facts

2. Company X is a private company and was incorporated with limited liability on 10 April 1970.

3. By an employer's return dated 20 April 1996, Company X reported the emoluments of the Taxpayer as follows:

Name of employee	:	the Taxpayer
Capacity in which employed	:	skilled worker
Period or employment	:	1-4-1995 to 31-3-1996
Salary	:	$198,998

4. By an employee's tax return issued to the Taxpayer on 18 July 1996, the Taxpayer reported his income as follows:

Employer	:	Company X
		$
Salary/Wages	:	122,298
Back pay, terminal awards and gratuities	:	21,240
Long service payment	:	55,460
Total income	:	198,998

5. The assessor raised the following assessment against the Taxpayer for the year of assessment 1995/96:

	$	$
Income		198,998
Less: Basic allowance	79,000	
Child allowance	44,000	123,000
Net chargeable income		75,998
Tax payable		7,519

6. By a letter dated 22 November 1996, the Taxpayer raised objection to the aforesaid assessment by reason that the severance payment of $55,460 was wrongly included in the assessment. He claimed that the sum was paid when all employees were dismissed by reason of redundancy at the time when new shareholders joined Company X. The Taxpayer's letter was also accompanied by a letter from Company X stating that the Taxpayer's income from 1 April 1995 to 31 March 1996 as follows:

		$
(1)	Salary	122,298
(2)	Bonus and double pay	21,240
(3)	Severance payment	55,460
		198,998

7. After the said objection letter, the assessor made enquiries with Company X which provided the following information:

(i) The Taxpayer was employed by Company X as a skilled worker both before and after 1 January 1996.

(ii) The Taxpayer commenced his employment with Company X on 2 July 1985.

(iii) As Company X restructured on 1 January 1996, it was necessary to pay the employees' long service payments accrued prior to the restructure.

(iv) After the restructure, the Taxpayer was invited to become a shareholder of Company X with 1/30 of the shareholdings.

(v) Pursuant to an oral agreement between them, the Taxpayer was further employed by Company X. The terms of the employment contract (an oral agreement), were substantially the same as those of the previous one.

(vi) The sum of $55,460 was arrived at as follows:

Period of employment	:	2 July 1985 to 31 December 1995
Salary	:	$295 per day
Calculation	:	18 days per year, 10 years in total = 188 days 188 x $295 = $55,460

8. The annual return of Company X for the year of assessment 1995/96 made up to 10 April 1996 showed that the issued and paid up capital of the company was $300,000 with 3,000 shares of $100 each and on 2 January 1996, a total of 1,500 shares of the company, were transferred from the then shareholders to some new shareholders and one of the new shareholders was the Taxpayer to whom 100 shares were transferred, being 1/30 of the issued share capital.

9. The assessor rejected the objection raised by the Taxpayer and explained to the Taxpayer that the sum in question could not be treated as severance payment as his employment with Company X had never been terminated and the said sum was not paid to him by Company X under the circumstances as provided under the Employment Ordinance. The Taxpayer was asked to withdraw his objection.

10. The Taxpayer refused to withdraw the objection. He alleged that the said sum was paid to him as remuneration for services of the past ten years and the same was calculated in accordance with the Employment Ordinance. After the restructure of Company X, he was engaged as a new employee. His years of service and benefits would be counted from 1 January 1996.

11. By a determination dated 8 October 1998, the Commissioner overruled the Taxpayer's objection.

12. Pursuant to section 64(4) of the Inland Revenue Ordinance ('the IRO'), the Commissioner by a covering letter dated 8 October 1998 forwarded to the Taxpayer his determination together with the reasons therefor and a statement of facts and also notified

the Taxpayer his right of appeal to the Board of Review within 1 month after the transmission of the Respondent's determination.

13. The said letter of 8 October 1998 was delivered by registered mail as addressed to District Y on 10 October 1998 and the same was received by a Mr Z.

14. By a letter to the Board of Review dated 10 November 1998, the Taxpayer gave notice of his appeal against the Respondent's (the CIR's) determination.

15. The hearing of the appeal was on 12 February 1999 when the Taxpayer appeared in person.

16. The Respondent raised the point that the Taxpayer's notice of appeal was filed out of time and requested the Board in the first instance to hear the Taxpayer's explanation on the delay and then to decide whether extension of time for late filing of the notice of appeal should be granted.

The preliminary issue

17. Whether extension of time should be granted to the Taxpayer as the notice of appeal was not given by him within the one month period as required under section 66(1)

(a) of the IRO, and

The substantive issue

18. If extension of time is granted, whether the Taxpayer should pay salaries tax on the amount of $55,460 received by him from Company X.

The decision

19. On the preliminary issue, section 66(1A) of the IRO provides that if the Board is satisfied that an appellant was prevented by illness or absence from Hong Kong or other reasonable cause from giving notice of appeal within the time prescribed by section 66(1)(a), the Board may extend the time for giving notice of appeal as it thinks fit.

20. At the hearing, the Taxpayer gave evidence and admitted that he had failed to give the notice of appeal within the statutory one month period. He explained that there was a delay because he was busy at work when he received the determination and then he went to China for about ten days and he only dealt with the determination upon his return by which time he was two days late. He further explained that he went to China because his grandmother passed away and he had to attend to her funeral.

21. The notice of determination was given to the Taxpayer on 8 October 1998 and by a letter dated 10 November 1998 but was received by the Board on 13 November 1998, the

Taxpayer gave notice of his appeal against the determination. The Respondent (the CIR) produced a record from the Immigration Department showing that the Taxpayer left for China on 3 November 1998 and returned to Hong Kong on 11 November 1998. Although the notice of appeal was dated 10 November 1998, it could not have been given by the Taxpayer earlier than 11 November 1998 because he admitted that he did not deal with the notice of determination until his return. On the basis of the said record, we accept that the Taxpayer was not in Hong Kong when the statutory one month period expired. He was late in giving his notice of appeal by a few days. Although the Taxpayer was in Hong Kong for the early part of the statutory one month period, as his trip to China was unexpected by reason of his grandmother's death, we are satisfied that the Taxpayer had a reasonable cause which prevented him from giving the notice within the specified time. Accordingly, we grant the Taxpayer extension of time for filing the notice of appeal.

22. We now come to the substantive issue. Section 8(1)(a) of the IRO provides that salaries tax shall be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from any office or employment of profit and section 9(1)(a) of the IRO provides that income from any office or employment includes any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite or allowance, whether derived from the employer or others.

23. It has been an established practice that the Inland Revenue does not tax severance payments and long service payments which are made under and by reason of the IRO. The Inland Revenue considers that these payments are compensation for loss of employment, thus not constituting income from employment within the meaning of section 8 of the IRO.

24. It is the contention of the Taxpayer that the sum of $55,460 received by him from Company X, is a severance payment and is not subject to assessment of salaries tax.

25. The bases of the Taxpayer's contention are summarized as follows:

(1) Company X restructured on 1 January 1996 when fifty percent of its shareholdings were sold by some of the shareholders. By reason of the restructure, the said sum was paid to the Taxpayer as a severance payment.

(2) The said sum was calculated in accordance with the provisions of the Employment Ordinance in respect of severance payments.

(3) Company X confirmed that the said sum was a severance payment and so did the Labour Department where the Taxpayer went for clarification.

(4) Company X being a new company after the restructure, would not be responsible for the employees' benefits and severance payments accrued prior to the restructure.

(5) After the restructure, the Taxpayer was re-engaged by Company X as a new employee. His period of service and benefits would be calculated from 1 January 1996.

26. The Taxpayer gave evidence that after 1 January 1996, apart from the change of shareholders, Company X's operation and structure remained the same and except for a slight increase in salary and forfeiture of one additional day of holiday after completion of three years employment, the terms of the Taxpayer's employment, his post and job nature remained the same.

27. It is apparent from the evidence adduced that the Taxpayer perceived the change of shareholders in Company X as a transformation of Company X from one company to another which he described as 'the old company' and 'the new company'. He considered that there was a cessation of business of Company X by reason of the change of shareholders, and he was dismissed by way of redundancy by 'the old company' and was re-engaged under a new contract by 'the new company'. His perception was ill-conceived. Company X is a limited company. In law, its existence was in no way affected by its change of shareholders. It had remained one and the same legal entity despite its change of shareholders on 1 January 1996, thus one and the same employer to the Taxpayer. Indeed, Company X filed the Taxpayer's return with the Inland Revenue Department which drew no distinction between his employment for the period prior to 1 January 1996 and his employment for the period after 1 January 1996. Likewise when the Taxpayer himself filed his tax return in respect of the year in question he did not differentiate between one employment contract and the other. He simply reported his employment with one employer and the total amount of his remuneration for the whole of the year in question.

28. While we have every sympathy for the Taxpayer, we are unable to come to terms with the bases of his contention. The said sum did not become a severance payment because Company X and the Labour Department said so, or because it was calculated in accordance with the formula provided under the Employment Ordinance in respect of severance payments. On the facts before us, the Taxpayer could not have been entitled to a severance payment because he had not been dismissed by reason of redundancy within the meaning of section 31B(2) of the Employment Ordinance ('the EO') which reads as follows:

> *'For the purposes of this Part an employee who is dismissed shall be taken to be dismissed by reason of redundancy if the dismissal is attributable wholly or mainly to the fact that:*
>
> *(a) his employer has ceased, or intends to cease, to carry on the business*
>
> *(i) for the purposes of which the employee was employed by him; or*
>
> *(ii) in the place where the employee was so employed; or*

> *(b) the requirements of that business for employees to carry out work of a particular kind, or for employees to carry out work of a particular kind in the place where the employee was so employed, have ceased or diminished or are expected to cease or diminish.'*

29. Our attention has also been drawn to section 31J(2) of the EO by the Respondent (the CIR) in its submission. However, we do not believe this section is relevant to this case as the owner of the business had always been Company X.

30. As the said sum had also been referred to by both the Taxpayer and Company X as a long service payment and was said to be paid to the Taxpayer for his past services, we have therefore also considered whether the said sum was in fact a long service payment made under and by reason of the provision of section 31(R) of the EO. Assuming that the Taxpayer was dismissed within the meaning of section 31T(1) of the EO, still he could not have been entitled to a long service payment by reason of section 31T(2), since the Taxpayer was immediately re-engaged by Company X on 1 January 1996, after termination of his previous contract on 31 December 1995.

31. In these circumstances, we are bound to find that the said sum constitutes neither a severance payment nor a long service payment within the meaning of the Employment Ordinance and the appeal must therefore be dismissed.