Case No. D2/86

Board of Review:

H. F. G. Hobson, *Chairman*, Richard Mills-Owens and D. V. Timms, *Members.*

11 April 1986.

Salaries Tax—whether reimbursement of the cost of medical and dental treatment provided to employees constituting a 'perquisite' under Section 9(1)(*a*) or 'income' under Section 8(1) of the Inland Revenue Ordinance.

The Appellants were employees of an organization who received medical and dental treatment, the costs of which were in some instances paid for directly by the employer and in some other instances directly by themselves and reimbursed by the employer, under a flexible arrangement. The revenue contended that these costs are taxable regardless of whether bills are paid directly by the employer or by means of reimbursement.

Held:

Neither reimbursement of the expenses of medical or dental treatment nor the direct payment by the employer in the circumstances of this case constitute a 'perquisite' under Section 9(1)(*a*) or 'income' under Section 8(1) of the Inland Revenue Ordinance.

Appeal allowed.

Cases referred to:

C.I.R. v. Humphreys [1970] HKLR 451
C.I.R. v. Lord Forster [1935] 19TC 738
Hartland v. Diggines [1926] 10TC 247
Hochstrasser v. Mayes [1959] 38TC 673
Machon v. McLoughlin [1926] 11TC 83
Nicol v. Austin [1935] 19TC 531
Reed v. Seymour [1927] 11TC 625
Robinson v. Cory [1934] 18TC 411
Sanderson v. Durbridge [1955] 36TC 239
Tennant v. Smith [1892] 3TC 158

J. G. A. Grady for the Commissioner of Inland Revenue.
G. Billis for the Appellants.

Reasons:

This is an appeal against the inclusion to their respective taxable incomes for the year of assessment 1978/79 of the cost of medical and dental treatment provided to Mr. CY and Mr. JD both employees of the HPC. Naturally the individuals were separately assessed but as

the Grounds of Appeal in each case were the same the Revenue and the Appellants agreed that both cases be heard together-particularly so since the result would be treated as a test case.

For convenience we are attaching a copy of the Determination (with Appendices A to D attached) by the then Commissioner of Inland Revenue since the Facts are not materially in contention, though Mr. G Billis, Chairman of the Staff Association of the HPC who appeared as the duly appointed representative of the Appellants did mention that the letter referred to in Fact 6 was followed by a fuller letter from the HPC dated 26th November 1984 and it is therefore attached.

This issues before us arise from the fact that the Appellants received medical and dental treatment, the costs of which were in some instances paid for directly by HPC and in some other instances directly by themselves and reimbursed by the HPC. It will be seen from Appendix A to the Determination that the arrangement with the HPC did not include all forms of dental treatment, that the amount and nature of treatment (whether medical or dental) was subject to an overriding decision by the HPC and that if the HPC appointed practitioners then external treatment costs would not be met: moreover hospitalization costs were limited to government hospitals.

The Inland Revenue contends that these costs are taxable regardless of whether the bills are paid directly by the employer or by means of reimbursement. In the view of Mr. J. G. A. Grady (Assessor, Appeals) who represented the Revenue, even the costs of treatment provided at clinics or under schemes which bind the employer to pay a given group of doctors a retainer are strictly speaking liable to tax as part of an employee's remuneration but are in fact excluded only because it is impossible to quantify the value of the treatment since it gives rise to no specific charge for the treatment actually carried out. In other words government servants would be taxed for treatment provided at government clinics but for the fact that no cash value can be put upon it.

Both Mr. Grady and Mr. Billis cited a number of cases.

It is noteworthy however that the only Board of Review case specifically on this topic is an unreported one (a copy of which was produced by Mr. Grady) and puzzling that it was not among the list of cases referred to Mr. Grady's original written submissions. The unreported case being so closely analogous to the issues under appeal deserves careful study. As the case is unreported it is necessary to append hereto a copy (plus an extract from the Commissioner's Determination) from which it will be seen that $17,494, part of medical expenses for treatment of the Taxpayer for some ailment of which he appears to have died, were treated by the Revenue as forming part of the deceased taxpayer's income. The Board of Review concurred in that finding, deriving its reasons for so doing (para II) from passages drawn from the HL decisions in the Hochstrasser case mentioned below. Examination of the Decision shows that the Board accepted as a fact that the Taxpayer was initially liable for the medical expenses (para 7) then took the line that the reimbursement "formed part of the Taxpayer's income …. from his employment because it was clearly a benefit directly arising

from the Taxpayer's employment being a reward for his services" (para 11). Having reached that view it is readily understandable that the Board should conclude that in the circumstances of that case the question of who was primarily liable to the hospital for its fees was not material to their decision. But curiously in para 12, when rejecting an argument that the payment of the bill did not increase the Taxpayer's wealth, the Board said his "wealth was *increased* by the discharge of *indebtedness* (our emphasis). This suggests that the Board might have reached a different conclusion if the responsibility for the Hospital bill was not legally the Taxpayer's.

Again though the Board laid no particular stress on the point, it should be noted that the choice of physician (and we imagine hospital) lay with the Taxpayer, not his employee (see Fact (2) of the extract).

We now propose to deal with the cited cases, many of which are referred to in the aforementioned Decision: the citation references will be found at the end of this Decision.

Tennant v. Smith

A bank's agent was compelled by the circumstance of his employment to occupy, rent free, the bank's house as part of his duties — did this amount to a perquisite of his employment? The Board in the unreported Decision believed that in reality the House of Lords favoured Mr. Tennant because the Revenue had got its tax through the taxation on the annual value of the premises.

But of the judgments given the following passages appear pertinent "But upon the principles to which I at first referred, your Lordships are to ascertain not whether Mr. Tennant has got advantages which enable him to spend more of his income than if he did not possess them, but whether he has got that which any words in the Statute point out as a subject on which it imposes taxation" (Page 164). Later "I come to the conclusion that the Act (Income Tax Act 5 & 6 Victoria Cap. 35) refers to money payments made to the person who receives them, though, of course, I do not deny that if substantial things of money value were capable of being turned into money they might for that purpose represent money's worth and be therefore taxable. The illustration given in the argument of the mode of arriving at a tailor's profits, and the mode of treating his stock-in-trade, suggest that money's worth may be treated as money, for the purposes of the Act, in cases where the thing is capable of being turned into money from its own nature" (p. 164). If this is indeed the true criterion then one wonders just how for example an injection or an ingested antibiotic or tonsillectomy can be translated back into money or money's worth.

Turning to page 167 Lord Watson says this "It is clear that the benefit, if any, which a bank agent may derive from his residence in the business premises of the bank is neither salary, fee, nor wages. Is it then a perquisite or a profit of his office? I do not think that it comes within the category of profits, because that word in its ordinary acceptation appears to me to denote something acquired which the acquirer becomes possessed of, and can depose of to his advantage, in other words money, or that which can be truned to pecuniary

account." The contemplation of the possibility of disposing of an appendectomy (or heart by-pass say) to one's advantage takes one into the realms of the metaphysical.

Lord MacNaughten (on page 170) looks at the matter in a pragmatic sense: "Then this question suggests itself,—Has not the Crown got all that it is entitled to in respect of this house when it received the duty on its full annual value?": this is the passage to which the Board in the unreported case referred when distinguishing Tennant's case. However if such an approach is admissible then it seems to us in the case before us the doctor's *receipt* is taxed but the Revenue also seeks to tax the employee as though the fee also formed part of his income, yet the payment or reimbursement by the HPC is in practice not a deduction from the HPC own profits since that body—relying as it does on Government subventions, is run at a loss: i.e. the doctor's fees are taxed twice without benefit of off-set. Later MacNaughten says (at P. 170) "I do not doubt that the occupation of the bank's house rent free, though not unattended with some inconveniences, is on the whole a considerable advantage to the Appellant. It is a gain to him in the popular sense of the word. Whether such a benefit or gain comes under the heading of "profits and gains" chargeable for Income Tax Purposes is the question submitted to your Lordhips. I use the expression "profits and gains" because that is the term which the Legislature uses as applicable to both Schedules of charge under which it is said the Appellant is chargeable." Then at page 171 he concludes "but a person is chargeable for Income Tax under Schedule D as well as under Schedule E not on what saves his pocket but on what goes into his pocket. And the benfit which the Appellant derives from having a rent free house provided for him by the bank brings in nothing which can be reckoned up as a receipt or properly described as income.".

Section 9(1) of the Hong Kong Ordinance reads "Income from any office or employment includes—(*a*) any ……. perquisite, or allowance whether derived from the employer or others ….". The Revenue agreed that we are not here concerned with allowances.

In the result in Tennant's case the House of Lords came to the conclusion that Mr. Tennant's occupation of the bank premises did not constitute an emolument or perquisite to him which was taxable. If it were not therefore for the specific statutory provision in sub-section (*b*) of section 9(1) then—assuming the decisions in Tennant v. Smith applied in Hong Kong—rent free premises would not be taxable as a perquisite of employees in Hong Kong.

Machon v. McLoughlin

An asylum attendant was taxed on his gross wage under a new contract, not on the net wage after deduction for living-in charges. His old contract gave him a smaller wage plus allowances in kind including free living-in advantages. In giving his judgment on page 89 Rowlett J said this:—

> "If a person is paid a wage with some advantage thrown in, you cannot add the advantage to the wage for the purpose of taxation unless that advantage can be turned into money. That is one

> proposition. But when you have a person paid a wage with the necessity—the contractual necessity if you like—to expend that wage in a particular way, then he must pay tax upon the gross wage, and no question of alienability or inalienability arises."

These words were quoted (in the Appeal at page 95) with approval by Warrington LJ who recognized that they involved two propositions: Whereas the second proposition was held to apply in Machon's case we cannot see that it has any application in the appeal before us. We note however that all the asylum employees were charged the same amount for any of the advantages they chose to take up and the advantages would be of the same nature for each employee. An employee who is treated for a cold is not receiving the same quality of advantage as one who is treated for a heart disease: in that sense the Machon case is distinguishable.

Applying the quoted passage to the case before us we cannot see how it can be said either (*a*) that the Appellants can turn the advantage of having a right to go to doctors into money or (*b*) that the Appellants are required to spend their salary in a given way upon doctors.

Hartland v. Diggines

Income tax on employer's salaries was voluntarily paid by the employer. The sums so paid were held to be emoluments of the Taxpayer.

The House of Lord's decision is of little value in the appeal before us. The only substantive issue raised was whether the element of voluntariness distinguished the case from previous cases where the tax so paid was treated as part of the Taxpayer's emoluments: their Lordships concluded that it did not.

Reed v. Seymour

This is the cricketer's benefit match case which went to the House of Lords in 1927 when their Lordships found for the taxpayer. There seemed to be no strong argument by the Revenue in that case that the sum the Taxpayer received by way of benefit was other than a true donation but the Crown had argued that "there is a usual or settled practice of the Cricket Club …. as to benefits given to the staff—a settled practice to show that there is some claim or title on the part of the cricketer to expect and receive a donation of this kind." Their Lordships in effect found that the gift was made to the cricketer not merely because he was one of the cricketing staff but in recognition of "special personal qualities or testimonials to the individuals concerned" (per Sargant). This element of "personal equation" Lord Sargant felt to be decisive in that case: It would seem that it was that element that was the causa causans—not the fact of his being a professional playing for the Club (the sine qua non).

Pausing for a moment we ask ourselves whether in the instant case there is a personal equation for HPC employees: of course nothing can be more personal than health, it varies from person to person and is dependent in most cases on the peculiarities or vagaries of

own's metabolism hence the same treatment my work for one patient and not for another. The treatment Mr. X may receive may be vastly different to Mr. Y—even though their illness is the same—as for instance where Mr. X is allergic to antibiotics. Hence Mr. X's treatment is not prescribed because he like Mr. Y is a HPC employee but because of Mr. X's own particular physical biological characteristics. The analogy with cricketer A who is more popular than cricketer B (and hence attracts a bigger audience and generally speaking a greater benefit) is perhaps strained but not, we think, to the point where some underlying principle cannot reasonably be discerned.

Robinson v. Cory

A civil servant occupied an official house in Singapore and a housing allowance when not in occupation. His salary plus the cash allowance was taxed: his occupation of the official house was not taxable following Tennant v. Smith. Though cited by Mr. Grady it really makes no new point and involves some distinguishing legal aspects, we will not therefore refer to it farther.

Nicol v. Austin

Payment by a company for the upkeep of the managing director's residence formed part of his emoluments. The only relevance of this case is that it shows that payments by the company of rates and Gardener's wages etc. were treated as emoluments even though they were not received by the Taxpayer.

Sanderson v. Durbridge

A local government officer's evening attendances entitled him to flat-rate cash allowances for outside meals. These allowances were taxable and, (the main issue,) were not tax deductible. This being an "allowance" case it is of no help for we are not here concerned with "medical/dental allowances". It was however referred to in order to show that it is immaterial whether the allowance is received in advance or by way of reimbursement: nonetheless that principle may not have any application to situations which are not concerned with allowances.

CIR v. Lord Forster

Lord Forster waived the "income" of a life annuity due to him by a company which had bought his life interest in land and the company thereupon agreed to pay certain insurance premiums for Lord Forster. This was cited by Mr. Grady as indication that it matters not whether the payment of the premia be made direct by the Taxpayer or by the company in discharge of the *Taxpayer's liability* to pay the premia. We accept this point could be relevant but as mentioned below it is possible to that in some instances at least the primary responsibility for doctor/hospital fees lay with the HPC. For reasons which appear below we do not believe we need to deal with this possibility.

CIR v. Humphreys

This is a Hong Kong Court of Appeal decision concerned with the taxation of travel allowances to a civil servant for the use of his own car for journey from his home in Kowloon to his surveying work in the New Territories, his office being in Tai Po. It was held that these were taxable. (The use of his car on surveying work was fully reimbursed to him but those reimbursements were not taxed.) Mr. Grady placed reliance on this case, yet in reality what the Taxpayer sought to do was to distinguish the circumstances of his case (involving the terms of his government service and the lack of conveniently located quarters) from the line of cases which had held that it is the employee's responsibility to get himself to his place of work (Blair-Kerr J at p. 473) and he was not travelling in performance of his duties therefore the decision in Owen v. Pook (doctor with a surgery at home) was not germane (Mills-Owens J at p. 485). As mentioned this is an allowance case.

Hochstrasser v. Mayes & Jennings v. Kinder

It is the decisions in this House of Lord's case which are heavily relied upon in the unreported Board of Review Determination. We therefore propose to examine the case in some detail.

Mayes and Jennings were employed by ICI which had an agreement with those of its married employees who chose to take it up to the effect that ICI would make loans to enable an employee to buy a house and if that employee was relocated and chose to sell his house and thereby incurred a loss ICI would make up the loss: as a quid pro quo ICI had the right to buy the house at a valuation. In Mayes case the Commissioners said the £350 Mayes received from ICI to make up the loss he incurred when he sold his house did not form part of his taxable income. In Jennings case (on much the same facts) a different body of Commissioners held that Jenning's loss was taxable income. Thereafter these cases were heard together: at each step the Judges (save one of three in the Court of Appeal) found for the Taxpayer.

Before dealing with the rationale we think it is in point to refer to the following comment by Viscount Simmonds at p. 706:—

> "But I think that the approach should not be exactly that of Parker LJ (the dissenting judge in the Court of Appeal). It is for the Crown, seeking to tax the subject, to prove that the tax is exigible, not for the subject to prove that his case falls within exceptions which are not expressed in the Statute but arbitrarily inferred from it. Thus, in the present case it is for the Crown to establish that a payment made under the housing agreement is a reward for the employee's services."

Adopting that statement we remind ourselves that it is for the Revenue to prove that the medical expenses are exigible to tax not for the employees to prove that the expenses fall within any exception since none exists for this situation.

Viscount Simmonds then goes on (p. 706):—

> "How, then, does the Crown seek to prove its case? It does not, and could not, suggest that the agreement is in any way colourable. Nevertheless it is driven to the argument that a payment made under it is a reward for services and nothing else. This argument it fortifies by a close analysis of the benefit or detriment accruing to or suffered by the employee, and concludes that no substantial consideration for the payment moves from the employee. My Lords, I altogether dissent from this argument and conclusion. There is nothing express or implicit in the agreement which suggests that the payment is a reward for services except the single fact of the relationship of the parties and it is clear enough from the case of Duke of Westminster v. Commissioners of Inland Revenue, 19 T.C. 490, that that fact alone will not justify such a conclusion. On the other hand, there is the significant fact that the salary earned by the employee compares favourably with salaries paid by other employers not operating a housing scheme, and is the same whether or not he takes advantage of the housing scheme."

Lord Radcliffe makes this point (p. 707): "The money (£350) was not paid to him as wages. The wages of employees are calculated independently of anything which they get under the housing scheme …."

The situation of the HPC employees is such that the medical scheme may be totally valueless for one employee if he never has a need for treatment and yet be very valuable for one who is very sick. As we perceive it the extent of financial commitment by the employer for treatment charges has no relationship whatever to the salary of the employee who receives treatment: it depends therefore not on his status in the HPC but on the state of his health.

Again Lord Radcliffe says at p. 707:—

> "The test to be applied is the same for all. It is contained in the statutory requirement that the payment, if it is to be the subject of assessment, must arise 'from' the office or employment …., while it is not sufficient to render a payment assessable that an employee would not have received it unless he had been an employee, it is assessable if it has been paid to him in return for acting as or being an employee …."

Lord Cohen takes the line that the £350 was not paid as a result of his service agreement (which may be said to be the sine qua non) but of the Housing Agreement (the causa causans). We believe that a similar argument is sustainable here: Viscount Simmonds earlier (p. 705) said:—

> "My Lords, if in such cases as these the issue turns, as I think it does, upon whether the fact of employment is the causa causans or only the sine qua non of benefit, which perhaps is only to give the natural meaning to the word "therefrom" in the Statute, it must often be difficult to draw the line and say on which side of it a particular case falls."

If the Crown cannot discharge the burden of establishing that the case comes within the charging section, then the Taxpayer must succeed, even though there may be a lack of conviction on the part of the Court that the case falls on the Taxpayer's side of the line.

Reverting to Lord Cohen, he makes the point (at p. 710) that the housing scheme was introduced "not to provide increased remuneration for employees but as part of a general staff policy to secure a contended staff and to ease the minds of employees …. The housing agreement itself gave advantages to the company which may not be easy to quantify but which are not negligible or colourable." Certainly it is in the interests of the HPC to encourage its staff to indulge in preventative treatment to avoid the potentially greater absenteeism likely to occur if the employee puts off doctors visits because of the cost of himself. We believe that rationale to be irrefutable (Skrimshankers always excepted).

Having reviewed the above cases we are of the opinion that neither the reimbursement of the expenses of medical or dental treatment nor the direct payment by the HPC in the circumstances of this case constitute of "perquisite" under section 9(1)(*a*) nor "income" under s. 8(1). Our reasons are as follows:—

1. The expenses could not be turned into money or money's worth.

2. The time when the commitment was made to the employees was upon their becoming employed. We do not think therefore that the promise of relief from future medical expenses can be said to be a reward for future services because he may never be ill and hence may never collect on the promise; or if he is ill he may not collect because he chooses not to do so or more to the point reimbursement may be denied him because he refuses to go to a governmental hospital.

3. The undertaking to forego treatment at a hospital of his own choice (from a personal standpoint a very valuable option) is in our view sufficient consideration to support the HPC's promise of reimbursement. This issue of consideration is touched upon in the Hochstrasser judgments.

4. The contract of employment with the HPC is the causa sine qua non but it is not the causa causans: sickness not employment is the causa causans.

5. It would be extremely odd that a person should be taxed for being ill and hence not at work earning his pay and even stranger that the more sick he becomes the more he is taxed (the worry of which is likely to make him even sicker still.).

In concluding that the reimbursement or payment of medical expenses in this case was *not* a reward for services and that the employment was not the causa causans we of course respectfully differ from the Determination in the unreported Board of Review case. The facts in that case are insufficiently clear to us but the taxpayer seems to have died while in hospital—death may have its own rewards but they are not usually treated as temporal benefits.

An issue was raised which might have been material had we not reached the above conclusions. This was whether, having promised the employee that his future doctors bills would be paid, and as it is common in Hong Kong for doctors to ask who is to be responsible

for their bills and the inference being that the HPC employees would reply “The HPC”, was there not a question of agency; i.e. that the employee was in reality acting as agent for the HPC who was the true principal in the transaction (see the letter of the 26 November 1984). The point is not without interest particulary as Mr. Grady argued that whether the payment was made by the HPC in discharge of its own liability or in discharge of the employees’ made no difference (following para 7 of the unreported Board of Review decision). However it would be otiose for us to comment upon this particular aspect.

The appeal is therefore upheld.

The citations of the cases referred to are as follows:—

Tennant v. Smith (1892) 3TC 158

Machon v. McLoughlin (1926) 11TC 83

Hartland v. Diggines (1926) 10TC 247

Reed v. Seymour (1927) 11TC 625

Robinson v. Cory (1934) 18TC 411

Nicol v. Austin (1935) 19TC 531

Sanderson v. Durbridge (1955) 36TC 239

CIR v. Lord Forster (1935) 19TC 738

CIR v. Humphreys (1970) HKLR 451

Hochstrasser v. Mayes (1959) 38TC 673