

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D28/95

Salaries tax – termination of employment – lump sum payment – when lump sum payment accrues to taxpayer – sections 11C and 11D of the Inland Revenue Ordinance.

Panel: Kenneth Kwok Hing Wai QC (chairman), John Lo Siew Kiong and Ronny Tong Ka Wah.

Dates of hearing: 22 and 23 November 1994.

Date of decision: 13 June 1995.

The taxpayer made a claim against his former employer with regard to arrears of housing allowance. The former employer reached a compromise agreement with the taxpayer to pay a sum of HK\$795,000 which was paid to the taxpayer after the termination of his employment. The Commissioner assessed the lump sum payment as income of the taxpayer in respect of the year in which his employment ceased. The taxpayer submitted that the amount should be spread over three years and that a legal fee should be deducted therefrom.

Held:

On a correct interpretation of sections 11C and 11D of the Inland Revenue Ordinance moneys received by the taxpayer subsequent to the termination of his employment are deemed to have accrued on the last day of the employment. The lump sum amount had been received in full by the taxpayer subsequent thereto and accordingly was liable to be assessed to salaries tax in respect of the year of assessment when the employment ceased. The Board also rejected the claim to deduct the legal fees because the same were not incurred wholly or exclusively in the production of the assessable income.

Appeal dismissed

[**Editor's note:** The taxpayer has filed an appeal against this decision but withdrawn later.]

Yim Kwok Cheong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

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1. This is an appeal against the determination dated 12 July 1994 by Mr Anthony Au-Yeung, Commissioner of Inland Revenue, increasing the salaries tax for the year of assessment 1990/91 from a net assessable income of \$250,000 with tax payable thereon of \$27,100 to a net assessable income of \$970,000 with tax payable thereon of \$145,500.

The Facts

2.1 In his salaries tax return for the year of assessment 1990/91 the Taxpayer reported that his principal office or employment was by Company A; that the capacity in which he was employed was as a director; that his salary from 1 April 1990 to 31 October 1990 was \$175,000; and that no expense or outgoing was claimed as a deduction.

2.2 Enclosed with his return was a letter dated 6 June 1992 claiming that he officially resigned from Company A on 13 March 1991 and that he had not yet received his salary of \$100,000 from 1 November 1990 to 28 February 1991 and the double pay of \$25,000.

2.3 Company A furnished a 1990/91 employer's return in respect of the Taxpayer showing a salary of \$250,000 from 1 April 1990 to 31 December 1990.

2.4 On 18 December 1991 the assessor raised on the Taxpayer a salaries tax assessment for the year of assessment 1990/91 based on an assessable income of \$250,000, which after deducting \$80,000 married persons' allowance and \$24,000 as child allowance gave a net chargeable income of \$146,000, with tax payable thereon of \$27,100.

2.5 By letter dated 6 January 1992, the Taxpayer objected to the salaries tax for the year of assessment 1990/91 on the ground that his income for that year should be assessed at \$175,000 and claimed a deduction of a legal fee of \$15,000 for the year of assessment 1991/92.

2.6 By an agreement dated 9 August 1991 made between Company A, the Taxpayer and another party ('the compromise agreement'), Company A and the other party acknowledged that they were jointly and severally indebted to the Taxpayer in the sum of \$795,000 being arrears of housing allowance due to the Taxpayer, and Company A agreed to pay the Taxpayer the sum of \$795,000, without interest, by 17 instalments as set out in the first schedule to the compromise agreement, that is, from July 1991 to October 1993.

2.7 Company A, the Taxpayer and the other party all signed the compromise agreement before the same solicitor.

2.8 In the letter dated 13 June 1992 to the assessor, Company A stated that the Taxpayer left Company A on 12 March 1991; that the actual amount paid to the Taxpayer during the year of assessment 1990/91 was \$175,000; and that the sum of \$795,000 stated in the compromise agreement was made up of housing allowance from April 1981 to October 1986 in the sum of \$670,000, salary for November 1990 to February 1991 in the sum of \$100,000 and double pay for 1990 in the sum of \$25,000.

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2.9 In an interview with the assessor on 21 October 1993, the Taxpayer confirmed that the information given by the employer in its letter dated 13 June 1992 was correct, and in particular that the actual amount of housing allowance should only be \$670,000 (and not \$795,000 as stated in the compromise agreement).

2.10 By letter dated 27 April 1994, the Taxpayer confirmed that he had by then received sums totalling \$795,000, the final payment of \$50,000 being made in October 1993.

2.11 Thus by the date of the Commissioner's determination, the Taxpayer had already received the total sum of \$970,000, \$175,000 of which was received during the year of assessment 1990/91 and \$795,000 was received subsequent thereto.

2.12 By a bill dated 21 October 1991, a firm of solicitors billed the Taxpayer for the lump sum of \$18,000 for professional services rendered in connection with the Taxpayer's recovery of the sum of \$795,000 and also in respect of 'the share holding arrangement'. It would appear that the solicitors agreed to a reduction and by 14 November 1991 received \$12,000 from the Taxpayer which, together with the costs on account of \$3,000 meant that the Taxpayer had paid a total of \$15,000 on legal fees.

2.13 Subject to claiming a deduction of the legal fee of \$15,000, the Taxpayer did not dispute the assessability of the sum of \$795,000 but contended that the sum should be assessed as income for the years of receipt as follows:

Year of Assessment	Amount to be assessed
1991/92	\$275,000 - \$15,000 = \$260,000
1992/93	\$270,000
1993/94	\$250,000

2.14 The Taxpayer also contended that since he left Company A and the other party, he was in self-employment to pursue the claim for \$795,000.

2.15 By his determination of 12 July 1994, the Commissioner increased the salaries tax for the year of assessment 1990/91 from a net assessable income of \$250,000 with tax payable thereon of \$27,100 to a net assessable income of \$970,000 with tax payable thereon of \$145,500.

Taxpayer's case on appeal

3.1 The Taxpayer basically agreed the facts as stated in the determination. His case on appeal was as summarised in paragraphs 2.13 and 2.14 above.

3.2 The Taxpayer expressly abandoned any reliance on relating back the sum of \$670,000 for housing allowance for 3 years, or for the period from April 1981 to October 1986.

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Our decision

4. After having carefully considered the submission and the papers placed before us by the Taxpayer, we did not think it was necessary to call on Mr Yim for the Commissioner. We told the parties that we would give our decision in writing. This we now do.

5. There is no dispute on \$175,000 which the Taxpayer reported in his salaries tax return for the year of assessment 1990/91.

6. The Taxpayer's contention that the sum of \$795,000 was derived from his self-employment after he had left Company A is in our decision wholly misconceived, and we reject it. We simply cannot see how pressing payment for outstanding emolument owed to the Taxpayer by Company A can be said to constitute a new employment of the Taxpayer by himself or to amount to a business.

7.1 We turn now to the Taxpayer's contention that the sum of \$795,000, subject to the claim for deduction of legal fee (which we shall deal with in paragraph 8 below), should be assessed as income for the years of receipt as set out in paragraph 2.13 above.

7.2 Section 8 of the Inland Revenue Ordinance (the IRO) Chapter 112, provides that:

'(1) 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 or profit ...'

7.3 Section 11B provides that:

'The assessable income of a person in any year of assessment shall be the aggregate amount of income accruing to him from all sources in that year of assessment.'

7.4 Section 11C provides that (emphasis added):

'For the purpose of section 11B, a person shall be deemed to commence or cease, as the case may be, to derive income from a source whenever and as often as he commences or cease:

(a) to hold any office or employment of profit

...'

7.5 Section 11D provides that:

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‘For the purpose of section 11B:

- (a) *income which has accrued to a person during the basis period for a year of assessment but which has not been received by him in such basis period shall not be included in his assessable income for that year of assessment until such time as he shall have received such income, when notwithstanding anything contained in this Ordinance, an additional assessment shall be raised in respect of such income...*
- (b) *Income accrues to a person when he becomes entitled to claim payment thereof:*

Provided that:

- (i) *any lump sum payment received on or after 1 April 1996, being a lump sum payment or gratuity paid or granted upon the retirement from or termination of any office or employment or any contract of employment of an employee or a lump sum payment of deferred pay or arrears of pay arising from an award of salary or wages, whether such a payment is paid by an employer to a person during employment or after that person has left his employ, shall upon the application in writing of the person entitled to claim payment thereof within 2 years after the end of the year of assessment in which the payment is made be related back and shall then be deemed to be income which has accrued during the periods in which the services or employment, in respect of which the payment was made, were performed or exercised, or, if the relevant periods of services or employment exceed 3 years, the payment shall be deemed to be income accruing at a constant rate over the 3 years ending on the date on which the person became entitled to claim payment thereof or ending on the last day of employment, whichever is the earlier; and notwithstanding section 70, an application made by any person under this proviso for the adjustment of an assessment shall, to that extent, be regarded as a valid objection to the assessment under section 64; and*
- (ii) *subject to proviso (i), any payment made by an employer to a person after that person has ceased or been deemed to cease to derive income which, if it had been made on the last day of the period during which he derived income, would have been included in that person’s assessable income for the year of assessment in which he ceased or is deemed to cease to derive income from that employment, shall be deemed to have accrued to that person on the last day of that employment.’*

7.6 Section 11D(b)(ii) is irrelevant as the Taxpayer has expressly abandoned any reliance thereon.

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7.7 The combined effect of sections 11C and 11D(a) and (b)(ii) is fatal against the Taxpayer's contention and we reject it.

7.8 By section 11C, the Taxpayer is deemed to cease to derive income from Company A upon termination of his employment with Company A on 12 or 13 March 1991.

7.9 By section 11D(b)(ii), the various payments totalling \$795,000 which were made after 12 March 1991, that is, after the Taxpayer has been deemed by section 11C to cease to derive income, are deemed to have accrued to the Taxpayer on the last day of employment, that is, on 12 March 1991.

7.10 By the date of the determination, the Taxpayer had received \$795,000 in full. Section 11D(a) requires an additional assessment to be raised in respect of such income. This is what the Commissioner has in effect done by increasing the assessable income of \$175,000 (as reported by the Taxpayer) by \$795,000 to \$970,000.

8.1 We turn lastly to the Taxpayer's claim for deduction of \$15,000.

8.2 Section 12(1)(a) provides that:

'(1)(a) all outgoings and expenses, other than expenses of a domestic or private nature and capital expenditure, wholly, exclusively and necessarily incurred in the production of the assessable income.'

8.3 The legal fee was partly for professional services rendered in respect of the 'share holding agreement'. We find on the facts that the Taxpayer has failed to prove that the legal fee was 'wholly' or 'exclusively' incurred in the production of the assessable income, and his claim for deduction fails.

9. For these reasons, we dismiss the appeal and confirm the assessment appealed against.