Case No. D30/11

Salaries tax – whether the sum should be chargeable to salaries tax – whether such payment constituted income 'from' the taxpayer's 'employment' – section 8(1) of the Inland Revenue Ordinance ('IRO') – a question of fact to be determined on the circumstances and available evidence – award by Labour Tribunal.

Panel: Colin Cohen (chairman), Emmanuel C C Kao and Patrick O'Neill.

Date of hearing: 5 August 2011.
Date of decision: 14 October 2011.

The Taxpayer was summarily dismissed. The issue to be decided is whether the sums which the Taxpayer received from his ex-employer, upon termination of his employment should be chargeable to salaries tax. These were: (a) a Labour Tribunal award referred to as 'Sum A'; (b) a sum referred to as 'Sum B' which was calculated by reference to the number of days of the Taxpayer's untaken leave.

The Taxpayer's position was that Sum A and Sum B were compensation for damages which he had received arising out of his wrongful dismissal and/or termination of his contract of employment with his ex-employer.

Held:

1. 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.

2. The key issue in deciding whether a payment received by an employee on termination of his employment was taxable was whether such payment constituted income 'from' the taxpayer's 'employment'. It is clear that not every payment which an employee receives from his employer is necessarily 'income from employment'. Income chargeable under section 8(1) of the IRO is not confined to income earned in the course of employment but embraces payments made 'in return for acting as or being an employee', or 'as a reward for past services or as an inducement to enter into employment and provide future services' (Fuchs v Commissioner of Inland Revenue [2011] 2 HKC 422, D103/97, IRBRD, vol 12, 555 and D43/92, IRBRD, vol 7, 424 followed).

3. The test is whether the payments arose from an employment for services, past, present or future and in turn, the Board need to look carefully at the true

nature of the payment. This is a question of fact to be determined on the circumstances and available evidence.

4. The Board accept that it does not necessarily follow that every award by the Labour Tribunal is necessarily non-taxable. The Board need to look very carefully at the nature of Sum A and in turn, they have come to the conclusion that Sum A was undoubtedly an amount which the ex-employer was liable to pay under the terms of the employment contract irrespective of such proceedings instituted.

5. The Board have come to the conclusion that both Sum A and Sum B clearly represented income that arose from the Taxpayer's employment with ex-employer and in turn, Sum A and Sum B were not paid as compensation whereby the Taxpayer had surrendered any contractual or legal rights.

Appeal dismissed.

Cases referred to:

Fuchs v Commissioner of Inland Revenue [2011] 2 HKC 422
D103/97, IRBRD, vol 12, 555
D43/92, IRBRD, vol 7, 424

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

Decision:

Introduction

1. This is an appeal by the Taxpayer in respect of a Determination dated 12 April 2011 ('the Determination') by the Deputy Commissioner of Inland Revenue ('the Deputy Commissioner'). The Determination was in respect of the salaries tax assessment for the year of assessment 2008/09 whereby the Deputy Commissioner reduced the net chargeable income to HK$506,640 with tax payable thereon of HK$66,128.

The issue

2. The issue to be decided is whether the sums which the Taxpayer received from his ex-employer, Company C upon termination of his employment should be chargeable to salaries tax. These were:

(a) A Labour Tribunal award of HK$400,000 referred to as 'Sum A' in the

Determination;

(b) A sum of HK$100,847.78 referred to as 'Sum B' in the Determination which was calculated by reference to the number of days of the Taxpayer's untaken leave.

3. The Taxpayer appealed by virtue of a letter dated 8 May 2011. In short, his position was that Sum A and Sum B were compensation for damages which he had received arising out of his wrongful dismissal and/or termination of his contract of employment with Company C.

The Taxpayer's evidence

4. The Taxpayer was previously employed by Company D from 1 December 2004 to 31 December 2006. Company D was owned by a company in Country E and he had previously worked at their headquarters in Country E. He confirmed that the contract he entered into with Company C dated 1 January 2007 was a fixed term contract commencing on 1 January 2007 and would be effective until 30 September 2008 ('the Employment Contract'). In particular, our attention was drawn to the following important clauses:

'1. **TERM, JOB TITLE AND NOTICE**

1.1 The Company shall employ the Employee and the Employee shall serve the Company as 'Regional Manager – [region concealed]' for a fixed duration of 21 months, starting as from January 1st 2007[.]

…..

1.3 Where the Company terminates the agreement in the period between January 1st 2007 and September 30th 2008, the Company shall pay on termination a sum equal to the total salary which would have been paid between the date of termination and September 30th 2008, with a minimum of 3 months.

…..

4. **REMUNERATION**

4.1 The Employee's **gross** salary shall be [currency concealed] 8,000. (Eight Thousand) per month. The salary shall be deemed to accrue from day to day and shall be payable monthly in arrears on the last working day of each month, twelve (12) times a year. The Employee shall not be entitled to receive any additional remuneration for work performed outside the normal hours of the Company. 13th salary-cheque and additional leave-pay are

not applicable on the present agreement.

4.2 In addition to the salary mentioned under Article 4.1, the employee shall be entitled to the following fringe benefits:

- Full use of a Company Car including its normal operational charges and fuel consumption.
- Housing and related expenses (insurance, electricity and water)[.]
- Two (2) return tickets per year in economy-class to/from [Country E].
- Social security coverage with [name of institution concealed] (premium remains at the discretion of the employer)[.]
- Ocean freight charges for maximum 30 cbm (1 x 20' FCL) for the removal of the Employee's personal effects to the place of employment, and back to [Country E] in case the overseas is being terminated by the Employer.

…..

6. **HOLIDAYS**

6.1 The Employee shall be entitled in addition to the local Bank and other public holidays, to 25 days paid leave in each calendar year, excluding official local public holidays.

…..

6.3 Upon termination of employment the Employee shall be entitled to be paid for leave that has accrued but is untaken up until the date of such termination.

…..

8. **TERMINATION**

…..

8.3 Any termination (which in this Agreement includes termination by repudiation) of the employment of the Employee hereunder shall not prejudice any rights of the parties hereto in respect of any liabilities or obligations arising under this Agreement prior to such termination nor shall it affect such of the provisions hereof as in accordance with their terms are intended to operate or have effect thereafter[.]

…..

11. **MISCELLANEOUS**

…..

11.4 This Agreement shall be governed and construed in accordance with the laws of [Country E].'

5. On 27 May 2008, Company C notified the Taxpayer of the termination of the Employment Contract with immediate effect. He told us that an expatriate lawyer came to the office, handed him his notice. He drew to our attention the fact that he was summarily dismissed, he was not paid any wages that were due to him. He was told to leave the office immediately.

6. He told us that a company in Country F has taken control of Company C during the course of his employment. He drew to our attention the various tensions and difficulties that took place between himself and the new owners. In short, there were cultural difficulties that arose.

7. However, despite the difficulties he remained in employment until 27 May 2008. Following his dismissal, he tried to take steps to obtain payment which he thought was due to him arising out of what he determined to be a wrongful dismissal. Various discussions took place between himself and various parties within Company C in an attempt to reach a settlement. Despite such discussions, he was forced to take matters to the Labour Tribunal in Hong Kong. However, in early July 2008, he received Sum B. He told us that he was of the view that he considered this to be a first instalment of the compensation payment due to him. He was hopeful that a further payment would be made, however, no such payment was received.

8. He drew to our attention that he took the view that he was entitled to lodge a claim for what he described as various fringe benefits that were due to him arising out of flights and expenses.

9. He told us that when he filed the relevant papers at the Labour Tribunal, he met with one of the officers who indicated to him that many of the items claimed would cause difficulties. After considering this advice, he lodged a claim for HK$400,000.

10. His attention was drawn to the fact that in the papers he filed in the Labour Tribunal, this claim was specifically identified as a claim for wages. His attention was also drawn to the fact that the Employment Contract was a fixed term contract. He told us that in his mind, part of the sums that were due to him were clearly salary. When he was asked to break down the claim filed in the sum of HK$400,000, he was somewhat vague and indeed, could not identify with any particularity what was his salary and exactly how much was due in respect of the other benefits. However, in any event, regard must be had to the fact that when he filed the claim at the Labour Tribunal, the sum claimed was clearly identifiable as a

claim for wages that were due.

11. He also drew to our attention that Company C did not attend the hearing. He obtained a default judgment in due course.

12. He drew to our attention the fact that Company C instituted proceedings in Country E in an attempt to claim damages from him arising out of various improper activities they alleged he carried out in Hong Kong and as well as a general claim for damages.

13. He provided us with a document from the Court in City G, Country E. The Court resoundedly dismissed Company C's claim in no uncertain terms.

14. He also drew our attention to Sum B. Again, he emphasized to us in his view this was never in his mind, payments due to him for unused leave. He drew to our attention the fact that he did not believe he was entitled to receive this under Country E's law.

15. On cross-examination by Miss Wong on behalf of the Inland Revenue Department ('IRD'), his attention was drawn to a letter dated 23 March 2011 from Company C to the IRD. There, Company C was replying to a letter from the IRD asking for details as to the breakdown of Sum B. In that letter, they confirmed that this was a calculation of the leave payment.

They stated:

> 'According to [Country E's] law when an employee leaves the company the yearly salary has to multiply by 15.34% as leave salary. He worked until Sep and he was[sic] entitled of 20 days leaves and 5 days had been taken. Therefore the calculation is as below
>
> [Currency concealed] 8000 x 9 * 15.34% * 15/20 =
> [Currency concealed] 8283.60'

16. Of course, the Taxpayer took exception to this. He drew to our attention that since he had left Company C at the end of May, how he could have taken any leave.

17. The Taxpayer also drew to our attention the fact that he has been forced to spend a considerable sum of monies to contest the proceedings taken against him by Company C in Country E.

18. In cross-examination, Miss Wong put to the Taxpayer that the Employment Contract was a fixed term contract. When asked to give a breakdown of the HK$400,000 as to which part was salary and which part was fringe benefits, he was unable to do so. When cross-examined regarding his leave, all he could say that this was a complicated calculation which in essence, was based on Country E's law.

The relevant legislation

19. Section 8(1) of the Inland Revenue Ordinance ('IRO') provides that:

> '*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; …..'*

20. Section 9(1)(a) of the IRO provides that:

> '*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, …..'*

21. Section 68(4) of the IRO provides that *'the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant'*.

The law

22. 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.

23. Our attention was drawn to Fuchs v Commissioner of Inland Revenue [2011] 2 HKC 422, D103/97, IRBRD, vol 12, 555 and D43/92, IRBRD, vol 7, 424. It is clear in these decisions that the key issue in deciding whether a payment received by an employee on termination of his employment was taxable was whether such payment constituted income 'from' the taxpayer's 'employment'. It is clear that not every payment which an employee receives from his employer is necessarily 'income from employment'. Income chargeable under section 8(1) of the IRO is not confined to income earned in the course of employment but embraces payments made 'in return for acting as or being an employee', or 'as a reward for past services or as an inducement to enter into employment and provide future services'.

Discussion

24. As Miss Wong quite rightly points out in her written submissions, the test is whether the payments arose from an employment for services, past, present or future and in turn, we need to look carefully at the true nature of the payment. This is a question of fact to be determined on the circumstances and available evidence. We have come to the conclusion that both Sum A and Sum B clearly represented income that arose from the Taxpayer's employment with Company C and in turn, Sum A and Sum B were not paid as compensation whereby the Taxpayer had surrendered any contractual or legal rights.

Sum A

25. In our view, one has to look very carefully and analyse the available documents before the Board. It is quite clear in our view that Sum A was taxable remuneration for the remaining term of the Employment Contract. There was a fixed term contract and in turn, Company C terminated the Taxpayer's employment on 27 May 2008. Therefore, pursuant to Clause 1.3, the Taxpayer was contractually entitled to a sum equivalent for the salary for the remaining period of the Employment Contract.

26. We need also to have regard to the documents before us. On 22 September 2008, the Taxpayer wrote to the IRD applying for a holdover of provisional tax. In that letter, he mentioned that he was still in dispute with Company C 'regarding unpaid salaries as from June – September 2008'. Indeed, in his application before the Labour Tribunal, it is quite clear and unequivocal that the claim was for four months salary.

27. Although the Taxpayer took proceedings in the Labour Tribunal, we accept that it does not necessarily follow that every award by the Labour Tribunal is necessarily non-taxable. We need to look very carefully at the nature of Sum A and in turn, we have come to the conclusion that Sum A was undoubtedly an amount which Company C was liable to pay under the terms of the Employment Contract irrespective of such proceedings being instituted. Hence, we conclude that Sum A is indeed taxable.

Sum B

28. There can be no doubt in our mind that Sum B is clearly 'leave pay' or 'payment in lieu of leave'. We have considered the evidence and looked carefully at the documents. In our view, it is clear that this sum was paid to the Taxpayer with regard to untaken leave. Indeed, the relevant documentation submitted by Company C supports such a contention. One also must have regard to Clause 6.3 of the Employment Contract which provided that upon termination of employment, the Taxpayer should be entitled to be paid for leave that had accrued but was untaken until the date of such termination. Hence, it is clear that this sum was indeed a reward for services and income from employment and taxable.

Conclusions

29. Therefore, having looked at matters very carefully and having regard to all the evidence before us, we come to the conclusion that both Sum A and Sum B are taxable and hence, we dismiss this appeal.