

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D36/03

Salaries tax – restructuring of a bank leading to the closure of a department where the appellant was employed – assessability of a sum paid by the bank on the cessation of the employment of the appellant – onus of proof on the appellant.

Panel: Ronny Wong Fook Hum SC (chairman), Emily Lam Yuet Ming and Tse Tak Yin.

Dates of hearing: 17 February and 2 June 2003.

Date of decision: 17 June 2003.

The appellant was employed as an ‘Associate Director’ of Bank A, Hong Kong Branch (‘the Bank’) with effect from 5 June 1995.

In 1996, the appellant was informed by the Bank that in recognition of his contributions he had been awarded 1065 units with a nominal value of \$1,000 in an incentive plan of Division B (‘the Plan’) with effect from 1 April 1997 in accordance with the rules of the Plan. Division B was the corporate and investment banking division of the Bank.

On 20 August 1997, the Bank filed a notification indicating cessation of the appellant’s employment on 31 July 1997.

In accordance with a final statement of the Plan agreed and accepted by the appellant on 14 April 1998, the Bank duly paid the appellant a sum of \$1,065,000.

The issue on appeal was the assessability or otherwise of this sum of \$1,065,000.

The appellant accepted that the Bank carried out a major restructuring of Division B and decided to close down the department that he worked for in early 1998. The appellant however maintained that the sum in question was damages arising from the Bank’s wrongful termination of the Plan. He said that such termination deprived him of the right to receive shares three years after the award and to enjoy any gain in the capital value of the Plan’s units. The payment therefore was not sourced from his employment. The payment was compensation for violation of his right to have the Plan remaining on foot so as to enable him to enjoy the two potential benefits which he identified.

The Revenue made enquiries with the Bank. The Bank explained that ‘HK\$1,065,000 was [the Plan of 1997] awarded to [the appellant]’. It was paid to him on 23 April 1998 as a result

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of the Bank's senior management decision in London to terminate this scheme following the restructure of Division B.

The facts appear sufficiently in the following judgment.

Held:

1. There was little dispute on the applicable principles. Two different approaches have been adopted in the authorities.
2. According to the wider approach, the issue was whether the payment in question was sourced from the employment.
3. According to the narrower approach, the Board had to examine the reason for the payment and be satisfied that the payment was to the employee and not as compensation for loss of employment or for other loss.
4. There was a sharp conflict between the Bank and the appellant as to the reason leading to the payment.
5. According to the Bank, the payment was pursuant to the contractual provisions of the Plan as summarized in the guide. The appellant's acceptance that there was a restructuring leading to closure of his department lent weight to the Bank's contention.
6. According to the appellant, termination of the Plan was a violation of his right. His difficulty stemmed from identification of such right. His rights under the Plan were regulated by the Plan's rules. He made no attempt to obtain those rules from the human resources department of the Bank. He could not identify the basis of his alleged right to have the Plan maintained for his potential benefit. There was no effective challenge of the Bank's case that the payment was pursuant to the provisions of the Plan.
7. The onus of proof was on the appellant. He failed to surmount the initial evidential burden.
8. For these reasons, the Board dismissed the appellant's appeal.

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Appeal dismissed.

Chan Siu Ying for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. By letter dated 18 May 1995, Bank A, Hong Kong Branch ('the Bank') offered to employ the Appellant as an 'Associate Director' with effect from 5 June 1995. The employment was terminable by either side by service of one month's notice in writing or payment of salary in lieu of notice.
2. By letter dated 2 December 1996, the Appellant was informed by the Bank that in recognition of his contributions he had been awarded units in an incentive plan of Division B ('the Plan'). Division B was the corporate and investment banking division of the Bank.
3. According to a certificate dated April 1997, the Appellant 'has been awarded 1065 [units of the Plan] with a nominal value of HK\$1,000 with effect from 1st April 1997 in accordance with the rules of [the Plan]'.
4. 'A Guide to [the Plan]' ('the Guide') described the plan as follows:
 - (a) The Plan 'is ... a core component of our total compensation package'.
 - (b) The Plan's units 'are performance-related units awarded to selected employees ...'.
 - (c) The Plan's units, once awarded, 'will be subject ... to the rules pertaining at the time of award'. The rules 'are available from [Division B] Human Resources'.
 - (d) The Plan's units 'will be revalued each year for three years from the base date, following the announcement of [the Bank's] full-year results. Revaluation will be on the basis of [Division B's] trading return on capital employed (TROCE) ...'.
 - (e) 'At the end of the three-year period, the Units will be translated into [the Bank's] shares, based on their value at that time. An independent employee trust will acquire the appropriate number of shares. All or some of the shares held in trust may, at the employee's request, be distributed by the trustee within

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a period of 30 days (first delivery window) following the third anniversary of the award base date ...’.

- (f) ‘Any shares not distributed to the employee will continue to be held in the trust, and may then not be distributed by the trustee, other than in certain circumstances, until the end of the fourth year, at which time a second 30 day delivery window will apply’.
- (g) ‘Question: What will happen in the event of a major corporate restructure, takeover or other material business change?’

Answer: The rules of the Plan allow for a deemed redemption in certain circumstances, whereby Unitholders would receive their accrued entitlement in cash and/or shares may be appropriate’.

5. On 20 August 1997, the Bank filed a notification indicating cessation of the Appellant’s employment on 31 July 1997.

6. According to a final statement of the Plan agreed and accepted by the Appellant on 14 April 1998:

- (a) ‘[The units of the Plan] awarded in April 1995, April 1996 and April 1997 have been revalued at “par” with effect from 1 April 1998, which means their current value remains unchanged.’
- (b) ‘The value of your [units of the Plan] with effect from 1 April 1998’ was ‘HK\$1,065,000’.

7. The employer duly paid the Appellant this sum of \$1,065,000. The issue before us relates to the assessability or otherwise of this sum.

8. There is little dispute on the applicable principles. Two different approaches have been adopted in the authorities. According to the wider approach, the issue is whether the payment in question was sourced from the employment. According to the narrower approach, we have to examine the reason for the payment and be satisfied that the payment was to the employee and not as compensation for loss of employment or for other loss.

9. The Appellant accepts that the Bank carried out a major restructuring of Division B and decided to close down the department that he worked for in early 1998. The Appellant however maintains that the sum in question was damages arising from the Bank’s wrongful termination of the Plan. He says that such termination deprived him of the right to receive shares

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three years after the award and to enjoy any gain in the capital value of the Plan's units. The payment therefore was not sourced from his employment. The payment was compensation for violation of his right to have the Plan remaining on foot so as to enable him to enjoy the two potential benefits which he identified.

10. The Revenue made enquiries with the Bank. The Bank was asked to 'confirm whether the sum of \$1,065,000 was made in accordance with the terms and circumstances stated in [the Plan]; if yes, please point out the part which your company has referred to'. In response thereto, the Bank explained that 'HK\$1,065,000 was [the Plan of 1997] awarded to [the Appellant]. It was paid to him on 23 April 1998 as a result of our senior management decision in London to terminate this scheme following the restructure of [Division B]'. The Bank then referred the Revenue to the 'Question and Answer' in the Guide quoted in paragraph 4(g) above.

11. There is therefore a sharp conflict between the Bank and the Appellant as to the reason leading to the payment. According to the Bank, the payment was pursuant to the contractual provisions of the Plan as summarised in the Guide. The Appellant's acceptance that there was a restructuring leading to closure of his department lends weight to the Bank's contention. According to the Appellant, termination of the Plan was a violation of his right. His difficulty stems from identification of such right. His rights under the Plan were regulated by the Plan's rules. He made no attempt to obtain those rules from the human resources department of the Bank. He could not identify the basis of his alleged right to have the Plan maintained for his potential benefit. There is no effective challenge of the Bank's case that the payment was pursuant to the provisions of the Plan. The onus of proof is on the Appellant. He failed to surmount the initial evidential burden.

12. For these reasons, we dismiss the Appellant's appeal.