

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D37/04

Salaries tax – whether severance payment and special notice payment income from employment.

Panel: Ronny Wong Fook Hum SC (chairman), Arthur Chan Ka Pui and Karl Kwok Chi Leung.

Date of hearing: 5 July 2004.

Date of decision: 27 August 2004.

The appellant and her employer, Company B concluded a separation agreement. The payments she received from Company B included a sum designated ‘Special Notice Payment’ which was computed on the basis of six times the appellant’s then monthly salary, and another sum designated ‘Severance Payment-Company’ which was computed on the basis of 12 times half of the appellant’s then monthly salary. Company B pointed out to the appellant that the second sum ‘is a company discretionary payment on top of the statutory requirement. This is a taxable item’.

Company B in its return reported to the Revenue the two sums as part of the income of the appellant. In response to inquiries from the Revenue, Company B informed the Revenue that ‘Special Notice Payment is the special payment from company for the special medical benefit to her’ and ‘Severance Payment – Company is the Company Discretion Payment which was paid on top of Severance Payment Government required’.

The appellant maintained that the two sums were not part of her income. In respect of the ‘Special Notice Payment’, she said the sum was paid ‘to cover the medical expense that [she] would have been able to claim if she was still working with [Company B]’. In respect of the ‘Severance Payment – Company’ she said Company B had selected her as part of a group of secretaries to be ‘outsourced’ to Company C under a transitional arrangement between Company B and Company C.

The questions the Board had to consider were:

- (a) Are the sums income from the appellant’s employment?
- (b) Are the sums remuneration In respect of the office or paid in consideration of the surrender by the recipient of her rights? Were the sums paid to the appellant in return for acting as or being an employee?

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Held:

1. The authorities suggest that there are two approaches in resolving these questions:
 - (a) According to the wider approach, the Board has to decide whether the payments were *sourced* from the employment.
 - (b) According to the narrower approach, the Board has to decide whether the payments were for services rendered by the appellant.

In the absence of full argument as to the appropriate approach to adopt, the Board decides to follow D80/00 where the Board adopted the narrower approach.

2. The Board is of the view that the ‘Special Notice Payment’ is not part of the appellant’s income. It was not paid in recognition of any past service of the taxpayer but in recognition of her physical predicament and her loss of coverage under the Company’s medical scheme. The Board discharges the assessment.
3. The Board is of the view that the ‘Severance Payment – Company’ is income of the appellant. It was computed with reference to the appellant’s length of service. That is a strong indicia that the payment was in recognition of the appellant’s past service with the Company. Company B clearly recognised that this payment is taxable. The Board confirms the assessment.

Appeal allowed in part.

Cases referred to:

D79/88, IRBRD, vol 4, 160

D80/00, IRBRD, vol 15, 715

Yeung Siu Fai for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

The appeal

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1. By letter dated 9 February 1989, the Appellant was employed by Company A as a secretary with a starting salary of \$5,800 per month. The business of Company A was transferred to Company B on 1 January 1998 and the Appellant became employed by Company B thereafter.
2. The Appellant did not enjoy good health. She had breast cancer in 1994 and was treated with mastectomy. As a result of her illness, she had to face substantial medical bills in respect of treatments which she received. Although her employer revised its medical scheme in 1995, she was allowed to remain on the old medical scheme with 80% reimbursement of her outlays.
3. By letter dated 5 June 2002, Company B give notice terminating the Appellant's employment as from 1 July 2002.
4. On 13 June 2002, Company B and the Appellant concluded a separation agreement. In consideration of Company B agreeing to make various payments, the Appellant agreed that her employment shall be mutually terminated as of 30 June 2002 and further agreed to release Company B 'from all claims, demands, actions or liabilities that I may have against [the Company] of whatever kind'. The payments from Company B included two sums of \$103,200 each. The first sum of \$103,200 was designated 'Special Notice Payment' which was computed on the basis of six times the Appellant's then monthly salary of \$17,200 ($\$17,200 \times 6 = \$103,200$). The second sum of \$103,200 was designated 'Severance Payment – Company' and was computed on the basis of 12 times half of the Appellant's then monthly salary of \$17,200 ($\$17,200 \times 0.5 \times 12 = \$103,200$). Company B pointed out to the Appellant that this second sum 'is a company discretionary payment on top of the statutory requirement. This is a taxable item.'
5. By return dated 4 July 2002, Company B reported to the Revenue the two sums of \$103,200 as part of the income of the Appellant for the period between 1 April 2002 and 30 June 2002.
6. The Appellant commenced employment with Company C on 1 July 2002. That employment was short-lived. It was terminated on 31 March 2003.
7. The Appellant maintains that the two sums of \$103,200 were not part of her income from Company B.
 - (a) In respect of the 'Severance Payment – Company', she said she had devoted 13 years of excellent service to the Company but the Company had selected her as part of a group of secretaries to be 'outsourced' to Company C under a transitional arrangement between the Company and Company C. It was very difficult for her to find a job of 'similar level' and this sum was to compensate her for her loss of tenure.

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- (b) In respect of the 'Special Notice Payment', she said she discussed her position with Ms D, Human Resources Executive of Company B immediately after she received the notice of termination. She pointed out to Ms D that the outsourcing arrangement would entail drastic cut in her medical benefits. Two days later she was informed by the company's financial controller that the company would pay her this sum 'to cover the medical expense that I would have been able to claim if I was still working with [the Company]'

8. In response to inquiries from the Revenue, Company B informed the Revenue that

'The payment of HK\$103,200.00 (severance payment over the Government Required) is the Company Discretion Payment which was paid on top of Severance Payment Government required. Another payment of HK\$103,200.00 (Special Notice Payment) is the special payment from company for the special medical benefit to her'.

The law

9. We have to ask the following questions:

- (a) Are the sums in question income from the Appellant's employment?
- (b) Are the sums remuneration in respect of the office or paid in consideration of the surrender by the recipient of her rights? Were the sums paid to the Appellant in return for acting as or being an employee?

10. The authorities suggest that there are two approaches in resolving these questions:

- (a) According to the wider approach, we have to decide whether the payments were *sourced* from the employment.
- (b) According to the narrower approach, we have to decide whether the payments were for services rendered by the Appellant.

11. In D79/88, IRBRD, vol 4, 160 this Board considered the taxability of gratuity payable to foreign staff members when leaving the service of a company at their own request. The Board took the view that the word 'gratuity' connotes a gift or present usually given on account of past services. Where the payment was made on account of something else (for example, in settlement of a claim for damages for wrongful dismissal), then the payment cannot properly be regarded as a 'gratuity'. The Board there agreed with the concession of the Revenue that where a

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payment was made as compensation for the loss of employment, the payment could not be said to be income from employment.

Our decision

12. In the absence of full argument as to the appropriate approach to adopt, we decide to follow D80/00, IRBRD, vol 15, 715 where the Board adopted the narrower approach.

13. We are of the view that the ‘Severance Payment – Company’ is income of the Appellant. It was computed with reference to the Appellant’s length of service. That is a strong indicia that the payment was in recognition of the Appellant’s past service with the Company. Company B clearly recognised that this payment is taxable.

14. We are of the view that the ‘Special Notice Payment’ is not part of the Appellant’s income. It was not paid in recognition of any past service of the Appellant but in recognition of her physical predicament and her loss of coverage under the Company’s medical scheme.

15. For these reasons, we allow the appeal in part. We confirm the assessment in respect of the ‘Severance Payment – Company’ but we discharge the assessment in respect of the ‘Special Notice Payment’.