

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D38/03

Salaries tax – whether a sum received by an appellant upon termination of his service was chargeable to salaries tax – reason for the payment – substantial element of the payment – a mixed purpose case – apportionment of the sum between the different elements of the payment.

Panel: Ronny Wong Fook Hum SC (chairman), Stephen Lau Man Lung and Kenneth Leung Kai Cheong.

Date of hearing: 5 May 2003.

Date of decision: 8 July 2003.

The appellant was appointed a director of a company ('the Company') on 28 December 1990. He commenced employment with the Company shortly thereafter on 1 January 1991.

The appellant's employment with the Company was terminated on 15 May 2000. On his departure, the appellant was paid a sum of \$360,000.

According to a receipt signed by the appellant, the said sum of \$360,000 was arrived at after deducting from long service pay of \$500,000 the sum of \$100,000 which he owed to the Company and \$40,000 being the Company's contribution towards his provident fund.

The Revenue conducted extensive enquiries with the Company and the appellant in relation to the reasons leading to the payment of \$500,000 to the appellant.

The issue in this appeal was whether the sum of \$500,000 paid to the appellant was chargeable to salaries tax.

The facts appear sufficiently in the following judgment.

Held:

1. The statement made by the Board in D3/97 must be understood in its proper context: see in particular paragraphs 2 and 6 thereof.
2. The approach adopted in D3/97 was helpful. The Board there found *'that on both sides the major reason for the payment was the compromise of*

INLAND REVENUE BOARD OF REVIEW DECISIONS

whatever claim that Mr A may have against Company B for the termination of his employment. We also find that one not insubstantial element of the payment was the fact that Mr A had rendered valuable service to Company B over a long period of time'. The Board there then proceeded to apportion the payment in question on the basis of the evidence before them.

3. The Board was of the view that this case too was a mixed purpose case. The appellant's past performance 'as both the employee and director of the Company' referred to in the Company's letter dated 15 April 2002 was not an insubstantial element leading to the payment.
4. On the other hand, the appellant was asserting claims for traveling allowances and housing benefits on the twin basis of his shareholding and his position.
5. The sum of \$500,000 was an overall settlement of these issues.
6. The Board had to do its best to apportion that sum between the different elements on the basis of the evidence before it.
7. The Board was of the view that a fair order was to apportion the balance of the sum of \$500,000 after deducting long service pay of \$105,238 in the ratio of two thirds (\$263,174.6) for past services and one third (\$131,587.3) for disputed claims.
8. The Board therefore allowed the appeal in part and directed that only the sum of \$263,174.6 was assessable to salaries tax.

Appeal allowed in part.

Cases referred to:

D3/97, IRBRD, vol 12, 115
Henley v Murray 31 TC 351

INLAND REVENUE BOARD OF REVIEW DECISIONS

Yeung Siu Fai for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. The Appellant was appointed a director of the Company on 28 December 1990. He commenced employment with the Company shortly thereafter on 1 January 1991.
2. The Appellant's employment with the Company was terminated on 15 May 2000. On his departure, the Appellant was paid a sum of \$360,000. According to a receipt signed by the Appellant, the sum of \$360,000 was arrived at after deducting from long service pay of \$500,000 the sum of \$100,000 which he owed to the Company and \$40,000 being the Company's contribution towards his provident fund.
3. The Revenue conducted extensive enquiries with the Company and the Appellant in relation to the reasons leading to the payment of \$500,000 to the Appellant.
4. The following representations were made on behalf of the Company:
 - (a) By letter dated 29 September 2001, the Company indicated that the sum of \$500,000 was 'severance payment' in favour of the Appellant and 'no special calculation' was applied in arriving at that figure.
 - (b) By letter dated 15 April 2002, the Company asserted that the sum of \$500,000 was 'for his past performance as both the employee and director of the company'.
 - (c) In response to the Revenue's enquiries dated 16 May 2002, the Company informed the Revenue that the payment was agreed between the parties at the Appellant's retirement 'so the Company was not necessary to pay any termination notice in lieu'. The Company further asserted that 'Long Service Payment per Employment Ordinance was \$105, 238.00 and the excess was additional payment'.
 - (d) By letter dated 31 March 2003, the Company explained that the sum was arrived at on the basis of:

$$\text{Average salary in the past 12 months} \times 2/3 \times \text{number of years employed}$$
$$\$16,616.66 \times 2/3 \times 9.5 \text{ years} = \$105,238.$$

INLAND REVENUE BOARD OF REVIEW DECISIONS

5. The following representations were made by the Appellant:

- (a) By letter dated 26 September 2001, the Appellant indicated that the sum of \$500,000 was an all inclusive sum covering long service pay and severance pay.
- (b) By letter dated 11 January 2002, the Appellant explained that he was claiming against the Company for:
 - (i) housing subsidy;
 - (ii) travelling allowance;
 - (iii) severance pay;
 - (iv) long service pay;
 - (v) pension and
 - (vi) retirement pay.

He was then earning \$15,050 per month. The Company agreed to settle those claims by paying him a sum computed on the basis of 36 months' salary. The resultant figure of \$541,800 was rounded down to \$500,000 in favour of the Company.

- (c) After being appraised of the Company's position as set out in the Company's letter dated 15 April 2002 as summarised in paragraph 4(b) above, the Appellant by letter dated 27 May 2002 informed the Revenue that he did not challenge the Company's assertions but on the basis of the Company's characterisation of the reasons leading to the payment of \$500,000, the Company has not paid him long service pay in the sum of \$140,466 and payment in lieu of notice in the sum of \$15,050. By letter of the same date, the Appellant demanded those two sums from the Company. The Appellant further invited the Revenue to assist him in such recovery.
- (d) In his 27 May 2002 letter, the Appellant further pointed out that he was a minority shareholder in the Company. As the Company's majority shareholder, the managing director enjoyed housing and travelling benefits. He had regular arguments with the managing director on those issues.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (e) By letter dated 26 July 2002, the Appellant reiterated that the sum of \$500,000 was an all inclusive figure embracing housing subsidy, travelling subsidy, pension, retirement benefit, severance pay, long service pay and payment in lieu of notice.
6. The Revenue is prepared to deduct the long service pay of \$105,238 from the sum of \$500,000 and assess the Appellant on the difference of \$394,762.
7. The Appellant adopts an alternative position:
- (a) If his explanation as to the rationale behind the sum of \$500,000 is accepted, he says that he is not liable as the same constitutes 'A payment made on account of compensation for loss of employment' within the principles as laid down by this Board in D3/97, IRBRD, vol 12, 115.
- (b) If, on the other hand, the Company's explanation as outlined in paragraph 4(b) above be accepted, he has not received his long service pay of \$105,238. Implicit in this concession is the suggestion that the Revenue should join in to put concerted pressure on the Company to exact the alleged outstanding payment. On this alternative case, there is no issue between the Appellant and the Revenue on the assessability of the sum of \$500,000. We do not therefore propose to deal further with this alternative case which in reality was advanced by the Appellant in protest against the Company's explanation.
8. The statement made by this Board in D3/97 must be understood in its proper context:
- (a) In paragraph 2 of the decision in that case, the Board expressly referred to the formulation of Jenkins LJ in Henley v Murray 31 TC 351 at 367:
- 'As the many cases on this topic show, it is very difficult to determine the character of a payment made to the holder of an office when the tenure of the office is determined or the terms on which he holds it are altered, and the question in each case is whether, on the facts of the case, the lump sum paid is in the nature of the remuneration or profits in respect of the office or is in the nature of a sum paid in consideration of the surrender by the recipient of his rights in respect of his office'.*
- (b) The Board made further reference to Jenkins LJ's formulation in paragraph 6 of the decision. The statement 'A payment made on account of compensation for loss of employment' must therefore be understood to refer to 'a sum paid in consideration of the surrender by the recipient of his rights in respect of his office'.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (c) On the facts in that case, the Board concluded that the Appellant was entitled to not less than 12 months' (as opposed to three months') notice for termination of his employment.

9. What we find helpful is the approach adopted in D3/97. The Board there found '*that on both sides the major reason for the payment was the compromise of whatever claim that Mr A may have against Company B for the termination of his employment. We also find that one not insubstantial element of the payment was the fact that Mr A had rendered valuable service to Company B over a long period of time*'. The Board then proceeded to apportion the payment in question on the basis of the evidence before them.

10. We are of the view that this too is a mixed purpose case. The Appellant's past performance 'as both the employee and director of the Company' referred to in the Company's letter dated 15 April 2002 is not an insubstantial element leading to the payment. On the other hand, the Appellant was asserting claims for travelling allowances and housing benefits on the twin basis of his shareholding and his position. The sum of \$500,000 was an overall settlement of these issues. We have to do our best to apportion that sum between the different elements on the basis of the evidence before us. We are of the view that a fair order is to apportion the balance of the sum of \$500,000 after deducting long service pay of \$105,238 in the ratio of two thirds (\$263,174.6) for past services and one third (\$131,587.3) for disputed claims.

11. We therefore allow the appeal in part and direct that only the sum of \$263,174.6 is assessable to salaries tax.