

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D39/94

Salaries tax – Performance Gratuity Scheme – date when gratuity accrues due.

Panel: Ronny Wong Fook Hum QC (chairman), Ronny Tong Ka Wah QC and Peter C White.

Date of hearing: 16 May 1994.

Date of further submissions: 26 May 1994

Date of decision: 27 September 1994

The taxpayer was entitled to a gratuity under a Performance Gratuity Scheme operated by his employer. The gratuity scheme rewarded the employee for performance over a three year period. The gratuity was paid as a lump sum on 15 July 1991 but was calculated in respect of three years namely 1988/89, 1989/90 and 1990/91. The assessor assessed the taxpayer to salaries tax in respect of the year of assessment 1991/92 in respect of the whole of the lump sum. The taxpayer claimed that the performance gratuity should be taxed on the basis that it related back to each of the three years during which the scheme had operated.

Held:

The payment of a gratuity can only be related back to previous years where the gratuity is paid upon retirement from or termination of employment. As the taxpayer did not cease his employment the gratuity did not relate back.

Appeal dismissed.

Cases referred to:

Re Industrial Conciliation & Arbitration Act 1908 [1909] 28 NZLR 933

Gordon v Jennings [1882] 9 QBD 45

Holloway v Poplar Corporation [1940] 1 KB 173

Tse Yuk Yip for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

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I. THE FACTS:

1. The Taxpayer is an employee of a company (the Employer).
2. The Employer operated a 'Performance Gratuity Scheme' ('the Scheme'). The duration of the Scheme was from 1 July 1988 to 30 June 1991. By that Scheme, the Employer intended to further reward its employees 'on the basis of their overall performance and the performance of the (Employer) over the three years period of the Scheme'.
3. The following are the principal features of the Scheme:
 - (a) It is not an annual bonus scheme.
 - (b) The gratuity computed in accordance with the provisions of the Scheme 'shall ... be payable to the Employee on Monday, 15 July 1991'.
 - (c) The gratuity is to be computed in the light of the following:
 - (i) The total salary of the Employee for each of the 3 years in question excluding his allowance.
 - (ii) The performance rating given to that Employee for each of the 3 years.
 - (iii) The gratuity percentage determined by the Employer for each of the 3 years in the light of its overall performance.

The gratuity payable is the sum total computed for each of the 3 years.

- (d) An Employee shall receive no benefit under the Scheme if he:
 - (i) terminates his employment of his own accord on or before 30 June 1991;
or
 - (ii) is dismissed by the Employer on or before completion of his period of probation; or
 - (iii) is dismissed by the Employer without notice or payment in lieu of notice pursuant to section 9 of the Employment Ordinance.
- (e) An Employee whose employment is terminated otherwise than in circumstances outlined in (d) above 'shall be entitled to a pro rata proportion of his gratuity entitlement for the period of his employment during the Scheme period'.

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4. On 15 July 1991, the Taxpayer received from the Employer a sum of \$33,954 being his gratuity entitlements under the Scheme worked out as follows:

Year	Amount \$
1988/89	7,130
1989/90	12,474
1990/91	<u>14,350</u>
	<u>\$33,954</u>

5. The Taxpayer was assessed salaries tax for the year of assessment 1991/92 on the basis that the whole of the sum of \$33,954 accrued in his favour on 15 July 1991. The Taxpayer however contends that he is entitled to invoke section 11D(b)(i) of the Inland Revenue Ordinance (the IRO) and have the payment related back to each of the 3 years of the Scheme.

II. THE RELEVANT PROVISIONS AND THE ISSUE

1. Section 8(1) of the IRO provides that 'Salaries tax shall ... be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from ... any office or employment of profit'.

2. Section 9(1) provides:

'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.'

3. Section 11B of the IRO provides:

'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.'

4. Section 11D of the IRO provides that:

'(b) income accrues to a person when he becomes entitled to claim payment thereof:

Provided that:

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- (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 paid, were performed or exercised ...'

5. As will be seen from above, section 11D covers two distinct and separate kinds of payment:

- (a) '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'; and
- (b) 'a lump sum payment of deferred pay or arrears of pay arising from an award of salary or wages'.

6. The issue is whether the payment made on 15 July 1991 of \$33,954 constitutes 'a lump sum payment of deferred pay or arrears of pay arising from an award of salary or wages'. There is no question of the payment in question being a payment made upon the retirement of the Taxpayer or termination of his employment.

III. OUR DECISION:

1. For the proviso to operate, 2 conditions must be satisfied:

- (a) There must be a lump sum payment of deferred pay or arrears of pay; and
- (b) such lump sum payment must have arisen from an award of salary or wages.

2. As explained in Re Industrial Conciliation & Arbitration Act 1908 [1909] 28 NZLR 933 'The term "salary" is ordinarily used to signify the periodical remuneration paid to professional men, clerks, or persons whose duty it is to superintend, and who have in every case an appointment of some permanency. It is never ordinary used as signifying the remuneration of manual labour, or of any labour when the element of permanency of employment is absent.'

3. In Gordon v Jennings [1882] 9 QBD 45, Grove J explained the term 'wages' thus:

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‘Now it may be that the term “wages”, according to the etymological meaning of the word, may be correctly applied to any remuneration for services, but it seems to me that the popular signification must be looked to. The term “wages” is not applied to the remuneration of a high or important officer of the state or a company, for instance, but to that of domestic servants, labourers or persons of a similar description’.

4. As far as gratuity is concerned, Asquith J in Holloway v Poplar Corporation [1940] 1 KB 173 thought that the word is wide enough ‘to cover any money gratuitously granted or paid, whether it is paid in one sum or in instalments’. When contrasted with the words ‘salary’ and ‘wages’, a gratuity is usually a payment made by the employer unilaterally in recognition of the employee’s services. As opposed to ‘salary’ and ‘wages’, it is not normally the product of consensual negotiations between the employer and the employee but rests essentially on the goodwill of the employer.

5. Section 9(1)(a) enumerates various items of ‘income’ to include ‘wages’, ‘salary’ and ‘gratuity’. The proviso in question also draws a distinction between ‘payment of deferred pay or arrears of pay’ and ‘gratuity’. Quite clearly, the reference to ‘lump sum payment of deferred pay or arrears of pay’ in the second part of the proviso does not include ‘gratuity’ referred to in the first part of the proviso or otherwise the same terminology would have been used. The Legislature must have intended to confine the application of the proviso to ‘gratuity’ to situations where the payment was made upon the retirement from or termination of office or employment. This is not the situation here.

6. For these reasons, we are of the view that the proviso is not applicable and we confirm the assessment by the Revenue.