

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D4/02

Salaries tax – whether acquisition of shares under a share option scheme chargeable to salaries tax – whether the person rendered services in the year of exercise of option relevant – additional salaries tax assessment – sections 8, 9 and 68(4) of the Inland Revenue Ordinance (‘IRO’).

Panel: Kenneth Kwok Hing Wai SC (chairman), Ng Yook Man and Anthony So Chun Kung.

Date of hearing: 26 January 2002.

Date of decision: 16 April 2002.

The appellant was a director of a company which is a subsidiary of Bank B. In early 1997, the appellant was transferred to London effective 7 April 1997. The appellant objected to the additional salaries tax assessment raised on him for the year of assessment 1997/98. The appellant claimed that the gain arising from the exercise of his right to acquire shares under a share option scheme should not be chargeable to salaries tax. The appellant appealed on the ground that during the relevant year of assessment, he rendered no services in Hong Kong and is therefore exempt from salaries tax pursuant to section 8(1A)(b)(ii).

Held:

1. The question under section 9(1)(d) of the IRO is whether the right to acquire shares or stock in a corporation was ‘obtained by a person as the holder of an office in or an employee of that or any other corporation’. If the answer is ‘yes’, then any gain realised by the exercise of that right is included as income from employment. Computation of the gain is governed by section 9(4). Section 9(5) provides that the charge under section 9(1)(d) operates to the exclusion of any charge under any other provision. Neither the question whether the person has rendered any services in the year of the exercise of the option nor the question of the place where the services were rendered in the year of the exercise of the option is relevant. Holding of an office or employment is only relevant to the capacity in which the option was obtained.
2. What section 8(1A)(b)(ii) excludes is ‘income derived from services rendered by a person who ... renders outside Hong Kong all the services in connection with his employment’. The option gain was not income derived from any services rendered

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by the appellant outside Hong Kong in the year of the exercise of the option, that is, 1997/98. Section 8(1A)(b)(ii) does not assist the appellant.

3. The onus under section 68(4) of proving that the assessment appealed against is excessive or incorrect is on the appellant. The appellant has not discharged the onus.

Appeal dismissed.

Cases referred to:

D43/94, IRBRD, vol 9, 278
D36/95, IRBRD, vol 10, 212
D29/95, IRBRD, vol 10, 247
Fuge v McClelland 36 TC 571
Abbott v Philbin 39 TC 82
Pepper v Hart & Others 65 TC 421
AZ v BY (Inspector of Taxes) 1998 STC (SCD)
CIR v George Andrew Goepfert 2 HKTC 210
David Hardy Glynn v CIR 3 HKTC 245
BR3/74, IRBRD, vol 1, 140
D55/91, IRBRD, vol 6, 424
D37/93, IRBRD, vol 8, 304
D40/95, IRBRD, vol 10, 275
D88/00, IRBRD, vol 15, 771

Lee Yun Hung for the Commissioner of Inland Revenue.
Steven Seiker of Messrs Baker & McKenzie for the taxpayer.

Decision:

1. This is an appeal against the determination of the Commissioner of Inland Revenue dated 28 September 2001 whereby the additional salaries tax assessment for the year of assessment 1997/98 under charge number 9-0093120-98-6, dated 10 July 1998, showing additional assessable income of \$5,665,308 and additional tax payable thereon of \$825,840 was confirmed. To give effect to the Tax Exemption (1997 Tax Year) Order, the additional tax payable under that charge was reduced to \$743,256.

The agreed facts

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2. The following facts are agreed and we find them as facts.
3. The Appellant has objected to the additional salaries tax assessment for the year of assessment 1997/98 raised on him. The Appellant claimed that the gain arising from the exercise of his right to acquire shares under a share option scheme should not be chargeable to salaries tax.
4. (a) By a letter of employment dated 27 July 1990, the Appellant was offered the position of director by Company A. The offer was accepted by the Appellant on 30 July 1990 with employment effective on 3 September 1990.
- (b) Company A is a subsidiary of Bank B. Bank B is a company incorporated in the United Kingdom and has at all relevant times maintained a place of business in Hong Kong.
- (c) Under the group's 'Executive Share Option Scheme' the Appellant was granted options to subscribe for shares in Company C. The relevant details of the options granted to the Appellant were as follows:

Date option granted	Number of shares granted	Subscription price per share	Total cost
		£	£
21-4-1992	20,000	1.16875	23,375
11-9-1992	6,000	0.95125	5,707
15-9-1992	4,000	1.03625	4,145
7-4-1993	10,400	1.75375	18,239
22-10-1993	15,600	2.53625	39,565
11-3-1994	12,000	2.80875	33,705
	<u>68,000</u>		<u>124,736</u>

5. Due to the transfer of part of the business of Company A to Bank B, the Appellant's employment was transferred to Bank B with effect from 1 January 1995. The employment letter is dated 16 December 1994 from Bank B to the Appellant. According to the terms of employment, the number of years of Appellant's service recognized by Company A for the purpose of service related benefits would also be recognized by Bank B.
6. All along the Appellant's income from Company A or Bank B has been assessed to salaries tax in full.
7. In early 1997 it was determined that the Appellant would be transferred to London effective 7 April 1997. The letter confirming this transfer and the terms of employment following the transfer is dated 11 March 1997.

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8. In March 1997 Bank B filed a notification regarding the Appellant's impending departure from Hong Kong. The notification showed, inter alia, the following:

Residential address:	Address D
Capacity in which employed:	Managing director
Reason for departure:	Transfer to London
Period of employment:	1-4-1997 to 6-4-1997
Particulars of income:	
Salary	\$54,133
Bonus	£70,000

9. In his tax return - individuals for the year of assessment 1997/98, the Appellant declared a total income of \$922,133 as follows:

Particulars	Amount
	\$
Salary	54,133
Bonus [£70,000]	<u>868,000</u>
	<u>922,133</u>

10. (a) On 24 March 1997 the assessor raised on the Appellant the following salaries tax assessment for the year of assessment 1997/98:

	\$
Assessable income per paragraph 9	922,133
<u>Less: Allowances</u>	<u>227,000</u>
Net chargeable income	<u>695,133</u>
Tax payable thereon	<u>128,226</u>

The Appellant did not object against the assessment.

(b) Pursuant to the Tax Exemption (1997 Tax Year) Order, the amount of tax payable of \$128,226 was subsequently reduced to \$115,403.

11. By a supplementary notification dated 1 June 1998, Bank B reported to the assessor that the Appellant had exercised his share option rights [see paragraph 4(c)] on 3 April 1997 and realised a total gain of £434,224. The gain was computed as follows:

	£
Value of shares as at exercise date [68,000 shares at £8.22]	558,960
Cost of shares [paragraph 4(c)]	<u>124,736</u>

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434,224

12. On 10 July 1998 the assessor raised on the Appellant the following additional salaries tax assessment for the year of assessment 1997/98:

	\$
Income per paragraph 9	922,133
<u>Add:</u> Share option gain per paragraph 11 [£434,224 converted at \$12.5242]	<u>5,438,308</u>
Assessable income	6,360,441
<u>Less:</u> Net chargeable income previously assessed per paragraph 10(a)	<u>695,133</u>
Additional assessable income	<u>5,665,308</u>
Additional tax payable thereon	<u>825,840</u>

13. The Appellant, through Messrs Baker & McKenzie, objected against the additional salaries tax assessment for the year of assessment 1997/98 in the following terms:

- (a) ‘ ... the gains from the exercise of the share options do not constitute income arising in or derived from Hong Kong, and [alternatively] that [the Appellant] rendered outside Hong Kong all services in connection with his employment during the relevant basis period, or [alternatively] that [the Appellant] visited for no more than 60 days during the relevant basis period.’
- (b) ‘ ... [the Appellant] physically left Hong Kong on 26 March 1997. He returned for one week from 25 June 1997 to 6 [July] 1997 to witness the events surrounding the resumption of Chinese sovereignty over Hong Kong. This visit was purely vocational and he did no employment-related work in Hong Kong during his stay.’

In the circumstances, it follows that [the Appellant] rendered all the services in connection with his employment during 1997/98 outside Hong Kong, and is therefore exempt from salaries tax pursuant to section 8(1A)(b)(ii) of the Inland Revenue Ordinance with respect to his employment earnings during that year of assessment.’

14. In reply to the assessor’s enquiries, Accountant’s Firm E, on behalf of Bank B, confirmed that the Appellant was on leave during the period from 26 March 1997 to 6 April 1997; and that Bank B paid remuneration to the Appellant up to 6 April 1997.

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15. Pursuant to the Tax Exemption (1997 Tax Year) Order, the assessor considered that the additional salaries tax assessment for the year of assessment 1997/98 should be revised as follows:

	\$
Additional assessable income per paragraph 12	<u>5,665,308</u>
Additional tax payable	<u>825,840</u>
<u>Less: 10% tax rebate</u>	<u>82,584</u>
Revised additional tax payable thereon	<u><u>743,256</u></u>

The appeal

16. The objection having failed, the Appellant appealed on the ground that:

‘ during the relevant year of assessment (1997/1998), [the Appellant] rendered no services in Hong Kong and is therefore exempt from salaries tax pursuant to section 8(1A)(b)(ii) ’.

17. At the hearing of the appeal, the Appellant was represented by Mr Steven Seiker while the Respondent was represented by Mr Lee Yun-hung.

18. Neither party called any oral witness.

19. Mr Lee Yun-hung accepted that in the year of assessment 1997/98, the Appellant did not render any service in Hong Kong and that as from 7 April 1997, the Appellant rendered services outside Hong Kong.

20. Mr Steven Seiker cited:

- (a) D43/94, IRBRD, vol 9, 278;
- (b) D36/95, IRBRD, vol 10, 212; and
- (c) D29/95, IRBRD, vol 10, 247.

21. Mr Lee Yun-hung cited:

- (a) Fuge v McClelland 36 TC 571;
- (b) Abbott v Philbin 39 TC 82;
- (c) Pepper v Hart & Others 65 TC 421;

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- (d) AZ v BY (Inspector of Taxes) 1998 STC (SCD);
- (e) CIR v George Andrew Goepfert 2 HKTC 210;
- (f) David Hardy Glynn v CIR 3 HKTC 245;
- (g) BR3/74, IRBRD, vol 1, 140;
- (h) D55/91, IRBRD, vol 6, 424;
- (i) D37/93, IRBRD, vol 8, 304;
- (j) D40/95, IRBRD, vol 10, 275; and
- (k) D88/00, IRBRD, vol 15, 771.

Our decision

22. Section 8(1)(a), (1A)(a) and (b)(ii), and (1B) of the IRO provides that:

‘(1) 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 ...

(1A) For the purposes of this Part, income arising in or derived from Hong Kong from any employment –

(a) includes, without in any way limiting the meaning of the expression and subject to paragraph (b), all income derived from services rendered in Hong Kong including leave pay attributable to such services;

(b) excludes income derived from services rendered by a person who –

...

(ii) renders outside Hong Kong all the services in connection with his employment ...

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(1B) *In determining whether or not all services are rendered outside Hong Kong for the purposes of subsection (1A) no account shall be taken of services rendered in Hong Kong during visits not exceeding a total of 60 days in the basis period for the year of assessment.'*

23. Section 9(1)(d) and (5) provides that:

'(1) Income from any office or employment includes –

...

(d) any gain realized by the exercise of, or by the assignment or release of, a right to acquire shares or stock in a corporation obtained by a person as the holder of an office in or an employee of that or any other corporation.'

'(5) Where salaries tax may by virtue of subsection (1)(d) become chargeable in respect of any gain which may be realized by the exercise of a right, salaries tax shall not be chargeable under any other provision of this Ordinance in respect of the receipt of the right.'

24. Mr Steven Seiker conceded that the gain from the exercise of the option was included in employment income by virtue of section 9(1)(d).

'The appellant does not contest the fact that the gain from the exercise of this option is included in employment income by virtue of 9(1)(d). We absolutely concede that 9(1)(d) states clearly that income from office or employment includes any gain from the exercise of an option.'

25. In our decision, Mr Steven Seiker was clearly correct in making the concession.

26. The question under section 9(1)(d) is whether the right to acquire shares or stock in a corporation was 'obtained by a person as the holder of an office in or an employee of that or any other corporation'. If the answer is 'yes', then any gain realised by the exercise of that right is included as income from employment. Computation of the gain is governed by section 9(4). Section 9(5) provides that the charge under section 9(1)(d) operates to the exclusion of any other charge under any other provision. Neither the question whether the person has rendered any services in the year of the exercise of the option nor the question of the place where the services were rendered in the year of the exercise of the option is relevant. Holding of an office or employment is only relevant to the capacity in which the option was obtained.

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27. Mr Steven Seiker sought to rely on section 8(1A)(b)(ii).

28. What section 8(1A)(b)(ii) excludes is ‘*income derived from services rendered* by a person who ... renders outside Hong Kong all the services in connection with his employment’ (emphasis added). The option gain was **not** income derived from any services rendered by the Appellant outside Hong Kong in the year of the exercise of the option, that is, 1997/98. Section 8(1A)(b)(ii) does not assist the Appellant.

29. The onus under section 68(4) of proving that the assessment appealed against is excessive or incorrect is on the Appellant. The Appellant has not discharged the onus.

30. As the above is decisive of the appeal, we do not think it is necessary to deal with the other points argued before us.

31. We dismiss the appeal and confirm the assessment as confirmed by the Commissioner who also reduced the tax payable to give effect to the Tax Exemption (1997 Tax Year) Order.