

# INLAND REVENUE BOARD OF REVIEW DECISIONS

## Case No. D40/95

**Salaries tax** – study leave – whether income assessable to salaries tax.

Panel: Ronny Tong Ka Wah QC (chairman), Gregory R S Crichton and Vincent Lo Wing Sang.

Dates of hearing: 8 and 9 May 1995.

Date of decision: 26 July 1995.

The taxpayer was a university lecturer who was granted study leave overseas. The question to be decided was whether the leave pay was assessable to Hong Kong tax.

Held:

The leave pay was subject to Hong Kong salaries tax.

**Appeal dismissed.**

Cases referred to:

CIR v George Andrew Goepfert [1987] 2 HKTC 210  
D50/89, IRBRD, vol 4, 527  
B/R 20/69, IRBRD, vol 1, 3  
CIR v Humphrey [1970] HKTC 451  
Blackwell v Mills [1945] 2 All ER 655

Wong Kuen Fai for the Commissioner of Inland Revenue.

Taxpayer represented by his auditor.

**Decision:**

### **THE FACTS**

1. The Taxpayer is a lecturer of University X ('the University'). On 10 December 1990, the Taxpayer applied to the University for study leave to pursue a doctorate degree in Canada with effect from 1 September 1991. The application was duly granted by the University as follows:

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- (a) Period of long leave/earned leave to be designated as study leave, on normal pay be granted from:

1 September 1991 to 31 October 1991 (61 days).

- (b) Additional study leave granted from:

(i) 1 November 1991 to 31 December 1991 (61 days on full pay);

(ii) 1 January 1992 to 27 February 1993 (424 days on half pay); and,

(iii) 28 February 1993 to 30 June 1993 (123 days on no pay).

- (c) Tuition fees were to be borne by the Taxpayer.

2. The Taxpayer went to Canada on 21 June 1991. While in Canada, the Taxpayer applied for and was granted further study leave without pay covering the period 1 July 1993 to 30 June 1994. Thereafter, he returned to Hong Kong and resumed his teaching duties with the University on 1 July 1994.

3. The University submitted a return of earnings for the year ended 31 March 1993 in respect of the Taxpayer as follows:

	\$
(a) Salary	225,991
(b) Back pay	<u>10,575</u>
Total:	<u>236,566</u>

4. The Taxpayer stated that he had no assessable income for the period from 1 April 1992 to 31 March 1993 in his salaries tax return for the year of assessment 1992/93 on the ground that he was absent from Hong Kong. The assessor raised on the Taxpayer the following salaries tax assessment for the year of assessment 1992/93:

	\$
Assessable income	236,566
<u>Less: married person's allowance</u>	<u>92,000</u>
Net chargeable income	<u>144,566</u>
Tax payable thereon	<u>26,741</u>

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5. The Taxpayer objected to the assessment on the ground that the leave pay was paid to the Taxpayer in return for services performed wholly outside of Hong Kong and consequently not taxable income. The assessment was confirmed by the Commissioner of Inland Revenue in a determination dated 9 November 1994 from which the Taxpayer now appeals.

### THE CASE OF THE TAXPAYER

6. We hope we will not do any injustice to the Taxpayer or his representative, Mr Y, who appeared before us if we are to summarise the case for the Taxpayer as follows that:

- (a) the duties of the Taxpayer included 'such duties as may in the opinion of [the University's Head of Department] be necessary for the proper functioning of the teaching department to which [the Taxpayer] is assigned' as provided in clause 4(a) v of the terms of service I (11th edition)('the terms of service');
- (b) the pursuit of the PhD degree in Canada was 'necessary for the proper functioning of the teaching department to which the Taxpayer was assigned';
- (c) the duties of the Taxpayer were not confined to teaching alone but extended to academic improvement;
- (d) this is supported or is reflected by clause 5(d) of the staff manual which reads: 'study leave shall comprise long leave in whole or in part and any extension thereto, and shall not be *leave-earning service*' (emphasis added).

7. At the end of the submission of Mr Y who appeared on behalf of the Taxpayer, the Taxpayer indicated he wished to address the Board. This was not objected to by the Revenue and we acceded to the request of the Taxpayer. The Taxpayer supplemented the submission of Mr Y by informing the Board that:

- (a) he performed some administrative duties even while he was studying in Canada;
- (b) the taking of 'leave' does not preclude the employee from performing other duties outside the normal place of work;
- (c) although he could not say that he was required to obtain the PhD degree, he would not have done so had he not been given certain 'signals' that he should do so;
- (d) there was a distinction between vacation and leave.

8. It will be seen that while some of the matters outlined above were submissions, others were really assertions of fact. This was pointed out to Mr Wong who appeared for

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the Revenue. Mr Wong very fairly indicated to the Board that he accepted the Taxpayer's assertions of fact as admissible evidence without requiring the Taxpayer to make those assertions of fact under oath or to be cross-examined on these matters. On this basis, the Board accepted the Taxpayer's assertions of fact as admissible evidence on the appeal.

### THE RELEVANT STATUTORY PROVISIONS

9. Section 8(1) of the Inland Revenue Ordinance (the IRO), chapter 112 is in these terms:

*'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; ...'*

10. 'Income' is defined in section 9(1) of the IRO as:

*'Income from any office or employment includes...*

*(a) any wages, salary, leave pay, ...'*

11. This is further supplemented by section 8(1A) which is in these terms:

*'For the purposes of this Part, income arising in or derived from Hong Kong from any employment...*

*(a) includes, ... 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;' (emphasis added)*

12. Prima facie, therefore, leave pay is taxable income. This is so whether or not the leave pay is wholly attributable to services rendered in Hong Kong. This is because section 8(1A)(a) is not a definition section but merely identifies a specific type of income as being taxable income. Since income includes leave pay (see section 9(1)), once it is determined that the relevant income is taxable by reason of section 8(1), the leave pay is taxable. The tax liability here does not depend on where the income was earned but the locality of the employment, in other words, the source of income (see CIR v George Andrew Goepfert [1987] 2 HKTC 210, especially at pages 27 and 29).

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13. In Board of Review D50/89, IRBRD, vol 4, 527, the Taxpayer there claimed that study leave pay received while he was in England should not be charged to salaries tax, or alternatively, that the tuition fee and air passage paid to attend the course he took in England should be allowable deductions under section 12(1)(a) of the IRO. Both contentions were rejected by the Board.

14. On the first point, the Board said this in relation to section 8(1) of the IRO at page 529 of the report:

*‘The expression “income arising in or derived from Hong Kong” is referable to the locality of the source of income: in other words not the place where the duties of the employee are performed but the place where the payment for the employment is made. Therefore, a person employed by a Hong Kong company and who is paid by the company from money originating in Hong Kong to perform services elsewhere is liable to salaries tax because his income arises in or is derived from Hong Kong (B/R 20/69, IRBRD, vol 1, 3 at 4 and 5). It is necessary to look for the place where the income really comes to the employee, that is to say, where the source of income, the employment, is located. Regard must first be had to the contract of employment (CIR v George Andrew Goepfert 2 HKTC 210 at 237);’*

15. On this basis, the Board found that the study leave pay received by the Taxpayer was taxable income under section 8(1). The Taxpayer, however, like the Taxpayer in this appeal, contended that he was exempt by reason of section 8(1A)(b) on the basis that all the services giving rise to the leave pay were rendered abroad. In answer to this submission, the Board said this:

*‘The Taxpayer contended that he was exempted under section 8(1A)(b). However, to qualify for such exemption, the claimant must, among other things, render outside Hong Kong all the services in connexion with his employment (section 8(1A)(b)(ii)). The Taxpayer obviously does not meet the requirements of sub-paragraph (ii). First, since the charge to salaries tax is referable to a whole year of assessment, it is implicit in sub-paragraph (ii) that it refers to the whole of the year of assessment in question. We therefore cannot accept the Taxpayer’s argument that the relevant period is not the year of assessment 1986/87 but the period of special leave from 4 November 1986 to 30 September 1987. That is sufficient to dispose of the Taxpayer’s contention. Second, we have to mention that that contention is based on the assumption that the studies he carried on in the United Kingdom were “services” within the meaning of sub-paragraph (ii). We think that it is very arguable that the studies were not services. However, as the point was not argued, we do not propose to go any further.’*

16. Apart from the fact that here, the Taxpayer was studying in Canada for the whole of the year of assessment, we cannot see any distinction between that case and the present appeal. The Revenue very fairly accepted that the Taxpayer’s argument here that

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his studies in Canada constituted 'services' was not expressly dealt with by the Board in D50/89. We do not see how this can assist the Taxpayer. On the second question as to whether the tuition fees and air fares paid by the Taxpayer were deductions, the Board in D50/89 said this:

*'[The Taxpayer's contention] raises two further questions: (a) whether the expenses were incurred in the production of the assessable income; and (b) whether they were wholly, exclusively and necessarily incurred.*

*Different tests have been used to decide question (a) in the courts in the United Kingdom and their Australian counterparts. The English test was adopted by the Full Court in Hong Kong in CIR v Humphrey [1970] HKTC 451 and has been applied in many cases in Hong Kong since. It asks the question, was the expense incurred at a time when the Taxpayer was in the course of performing the duties of his office or employment? As an academic staff member, the Taxpayer's work in the university consisted of both teaching and research. However, we do not think that when attending the master's degree course in London, he was on duty as an academic staff member. His course of study commenced in London on 30 September 1986, and he paid the balance of his tuition fee to the amount of £3,470 on the same day, a deposit of £385 having been paid on 31 July 1986. The sum of £3,470 was therefore not paid when the Taxpayer was on duty and was not an expense incurred in the production of the assessable income. (See Blackwell v Mills [1945] 2 All ER 655.)'*

17. Authorities aside, by reason of section 68(4) of the IRO, the burden is on the Taxpayer to show that the pay he received while on study leave was not attributable to services rendered in Hong Kong within the meaning of section 8(1A)(a) but constituted income derived from services rendered by the Taxpayer wholly outside Hong Kong. To this point, we now turn.

### **WHETHER PAY ATTRIBUTABLE TO SERVICES RENDERED IN HONG KONG**

18. Mr Y accepted that salary paid to the Taxpayer while he was studying on annual leave was taxable in that annual leave was 'earned' after services were rendered to the University in Hong Kong. But he maintained that salary paid to the Taxpayer while on study leave was different. He was, however, unable to articulate precisely what was the difference.

19. In our view, for present purposes there are no material differences between annual leave and study leave. The appointment of the Taxpayer was expressly stated to be subject to the terms of service. Clause 13(a) of the terms of service provided as follows:

*'Subject as is hereinafter provided, an appointee shall be entitled to long leave with pay up to a maximum period of one year. Long leave shall accumulate at the rate of one-sixth of a period of service. For the purpose of this clause a period of service shall start on the day on which the appointee assumes duty*

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either on first appointment or on returning from long leave and shall include vacations, public and University holidays, sick leave, conference leave, annual leave and maternity leave; but shall *exclude* periods taken of long leave, *study leave*, ... or any other form of leave.’ (emphasis added)

20. Clause 18 further provided that:

‘The grant of study leave, ... shall be governed by such regulations as the council may make from time to time.’

21. These regulations are contained in the staff manual. Clauses 1 to 3 of the staff manual provided that an applicant should apply to the committee on study leave (‘Committee’) for such leave. An applicant should satisfy the Committee that the course of study or research work to be undertaken would be ‘of sufficient importance and relevance to his academic work to justify the award of study leave.’

22. Clause 5 of the staff manual is in these terms:

‘Study leave shall be granted on the following conditions:

- (a) adequate provision shall have been made for the fulfilment of the applicant’s teaching duties during any *period of absence* which is in excessive of *earned leave*;
- (b) the period of designated study leave shall be not longer than two academic years, ...;
- (c) study leave shall comprise long leave in whole or in part and any extension thereto, and shall *not* be leave-earning service;
- (d) an applicant shall have served a minimum of two years and six months as a full-time assistant lecturer or above;
- (e) an applicant who resigns while on study leave, or retires or resigns within three years of returning from study leave ... may be required by the council to repay the whole or part of the sum received for passages and emoluments in connection with the study leave.’ (emphasis added)

23. Two points arise from a careful reading of these provisions:

- (a) A full-time assistant lecturer or above of the University is *entitled* by virtue of his position and his length of service to apply for study leave with pay;
- (b) Study leave is not to be counted as part of the applicant’s period of service.

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24. In these circumstances, quite clearly, pay received by the Taxpayer while on study leave was leave pay attributable to services rendered in Hong Kong in respect of an employment of profit here within the meaning of section 8(1) and (1A)(a) of the IRO. Conversely, such pay could not be income derived from services rendered by a person who '[rendered] outside Hong Kong *all* the services in connection with his employment' within the meaning of section 8(1A)(b)(ii).

25. This is sufficient to dispose of the appeal. However, in view of the very detailed submissions made to us, we feel that we should also deal with some of the Taxpayer's arguments briefly.

### **MEANING OF THE WORD 'LEAVE'**

26. In our view, the submission that the taking of study leave constituted service is without substance. The ordinary and natural meaning of the word 'leave' is:

- '(a) Permission to be absent from one's normal duties, employment, etc;
- (b) Absence from work etc;
- (c) a period of such absence.' (The New Shorter Oxford English Dictionary, third edition.)

27. This ordinary meaning is obviously the meaning intended in clause 13 of the terms of service and clause 5 of the staff manual quoted above and also clauses 15, 16, 17 and 18 of the terms of service. The fact that permission is required before any leave, including study leave can be taken also supports the meaning above.

### **STUDY LEAVE CONSTITUTED DUTIES REQUIRED OF THE TAXPAYER**

28. Equally, the contention that the taking of study leave constituted the performing of duties required of the Taxpayer is to be rejected. Mr Y, on behalf of the Taxpayer relied heavily on clause 4 of the terms of service:

- '(a) The duties of a teacher shall be:
  - (i) ...
  - (ii) contributing to scholarship;
  - (iii) ...
  - (iv) ...
  - (v) such duties as may in the opinion of its Head be necessary for the proper functioning of the teaching department to which the teacher is assigned;



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(vi) ...’

29. There is, however, no evidence that the Taxpayer was required or ordered by the Head of Department to take the study leave in question or the PhD course. Obviously, the choice of the degree or course in question was that of the Taxpayer’s.

30. The Taxpayer produced two letters from his past and present Heads of Department respectively. We cannot see how he can be assisted by these letters. The first letter came from the Taxpayer’s previous Head of Department, Professor K. That letter made it plain that the choice of the course was entirely that of the Taxpayer’s. While Professor K tried to use language which suggested it was within the Taxpayer’s duties to better himself academically, this could not be the contractual duties of the Taxpayer. With the greatest respect, the contractual duties of the Taxpayer were not matters to be defined by Professor K. They were governed by the contract of employment between the Taxpayer and the University and were set out in the contractual documents such as the terms of service and the staff manual to which we have referred to above. In any event, Mr Y accepted, and we think the Taxpayer must also, that whether it was within the duties of the Taxpayer to take study leave was a matter for us to decide based on the evidence before us and not Professor K.

31. The second letter was from the Taxpayer’s present Head of Department, Dr V. This letter is of even less relevance since Dr V was not even at the University when the Taxpayer applied for study leave.

### **OTHER POINTS SUBMITTED BY THE TAXPAYER**

32. We attached no significance to the Taxpayer’s assertion that he performed certain administrative duties while on study leave. The regulations we have looked at do not require the teacher to perform any duties before he can claim his leave pay. On the contrary, paragraph 5(a) of the staff manual provided that the applicant for study leave must arrange for the ‘fulfilment’ of his teaching duties during his absence in excess of earned leave. Performance of the kind of administrative duties outlined by the Taxpayer clearly do not constitute a prerequisite for the payment of leave pay.

33. Finally, it was said that had it not been ‘signals’ given to him by the University, the Taxpayer would not have embarked upon the further degree which he took. We think this submission is less than genuine. The further degree was as much a self-improvement for the Taxpayer himself as beneficial to the University. In any event, these ‘signals’ fell far short of the kind of contractual obligations that we are concerned with.

### **OUR DECISION**

34. For all these reasons, we are firmly of the view that the appeal ought to be dismissed.