

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D43/04

Salaries tax – payment upon termination in addition to payment in lieu – whether compensation.

Panel: Colin Cohen (chairman), Charles Nicholas Brooke and Malcolm John Merry.

Date of hearing: 16 July 2004.

Date of decision: 8 September 2004.

The taxpayer was employed by Bank B as a vice president. It was provided by a letter (the Second Supplementary Letter) that Bank B would provide five months' salary upon termination in addition to the payment in lieu. Later, the taxpayer was terminated and received the five months' salary as stipulated.

Held:

1. The five months' salary was part of the remuneration which the taxpayer was entitled to in respect of his employment with Bank B.
2. However, it was not a compensation payment as there was no loss or surrender of any right on the taxpayer. (D80/00; Comptroller General of Inland Revenue v Knight followed).
3. Thus, it was sourced from his employment and being taxable.

Appeal dismissed.

Cases referred to:

D43/93, IRBRD, vol 8, 323

D16/95, IRBRD, vol 10, 144

D90/96, IRBRD, vol 11, 727

D24/97, IRBRD, vol 12, 195

D80/00, IRBRD, vol 15, 715

D107/02, IRBRD, vol 18, 32

Comptroller General of Inland Revenue v Knight [1973] AC 428

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Tsui Nin Mei for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Introduction

1. This is an appeal by Mr A ('the Taxpayer') against a determination by the Deputy Commissioner of Inland Revenue dated the 25 March 2004. In that determination, the Deputy Commissioner overruled the Taxpayer's objection on the salaries tax assessment of the Taxpayer for the year of assessment 2000/01 showing assessable income of \$5,406,516 with tax payable thereon of \$810,977.
2. It is not in dispute that the Taxpayer had received a total sum of \$5,406,516. The Taxpayer's case is that out of the sum of \$5,406,516 the sum of \$514,150 was not taxable.
3. The question therefore which arises in this appeal is whether the sum of \$514,150 was income 'arising in or derived from ... any office or employment of profit' within the meaning of section 8(1) of the Inland Revenue Ordinance ('IRO').

The facts

4. The following facts were agreed and are not in issue:
 - 4.1 (a) By a letter dated 25 November 1994 ('the Employment Letter') issued by Bank B (which is currently known as Bank C), the Taxpayer was offered the position of vice president – treasury of Bank B.
 - (b) By a letter dated 1 August 1998 ('the First Supplementary Letter'), Bank B offered to provide a sum of six months' salary in addition to the severance payment made to all staff to the Taxpayer in the event of redundancy or termination of employment other than cause.
 - (c) By another letter dated 17 March 1999 ('the Second Supplementary Letter'), Bank B offered to provide a sum of five months' salary in addition to the severance/termination package personally available to the Taxpayer in the event of redundancy or termination of employment other than cause if the redundancy or termination of employment occurred within a period of 18 months after the completion of the change of the existing controlling

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shareholder of Bank B. The Second Supplementary Letter also specified that the arrangement as set out in the First Supplementary Letter (see (b) above) would become null and void and cease to have effect since then.

4.2 On 21 May 2001, Bank B filed a notification regarding the Taxpayer's cessation of employment. The notification showed, among other things, the following:

Period of employment	:	1-4-2000 – 31-3-2001
Capacity in which employed	:	SVP – Treasurer
Reason for cessation :		Redundancy
Particulars of income :	\$	
Salary		1,233,960
Leave pay		29,795
Bonus		766,986
Long term incentive bonus		1,940,625
Housing allowance		375,000
Termination compensation		<u>514,150</u>
		<u><u>4,860,516</u></u>

4.3 In his 2000/01 individual tax return, the Taxpayer declared the following employment income:

Name of employer	Capacity	Period	Amount
Bank B	SVP- Treasurer	1-4-2000 – 31-3-2001	4,346,366
Company D	SVP - Treasurer	1-4-2000 – 27-2-2001	<u>546,000</u>
			<u><u>4,892,366</u></u>

4.4 The assessor raised on the Taxpayer the following 2000/01 salaries tax assessment:

	\$
Assessable income	4,860,516
Bank B	<u>546,000</u>
Company D	<u><u>5,406,516</u></u>
Tax payable thereon	<u><u>810,977</u></u>

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The evidence

5. The Taxpayer gave evidence before us. In his evidence, the Taxpayer said that he returned from Country E and commenced employment with Bank B on 2 January 1995. He confirmed that his contract of employment may be terminated by either party by giving one month's written notice upon completion of the probation period. He said that due to the 1997 Asia financial crisis and the difficulties Bank B was facing, there was pressure being put upon the controlling shareholder to consider selling Bank B. On 1 August 1998, the Taxpayer signed the First Supplementary Letter. This letter stated:

‘ Dear [Mr A],

This serves to confirm that effective August 1, 1998, in case you are made redundant and/or being terminated by the Bank other than cause, you will be entitled to a cash compensation equals to 6 months' salary in addition to the severance payment made to all staff.

Please note that other terms and conditions of your employment contract remain unchanged’

The Taxpayer stated that this letter was to maintain the stability of management of Bank B.

6. On 17 March 1999, the Second Supplementary Letter was signed. He stated that the reason for the Second Supplementary Letter was due to the fact that the First Supplementary Letter was too simple and miscalculated the number of months of salary he would be entitled to in the event of a termination taking place. The Second Supplementary Letter stated the following:

‘ **Re: Termination Compensation in the Event of
Redundancy or Termination Other Than Cause**

This serves to confirm that in case you are made redundant and/or being terminated by the Bank other than cause during [the period of 18 months from the completion date (the “Assuring Period”) of the controlling shareholder change of the Bank (i.e. the change of the existing controlling shareholder [XXX] Bank Holding Company Limited),] you will be entitled to a termination compensation equal to 5 months' salary in addition to the severance/termination package available under your existing employment terms and conditions ...

In case you are made redundant and/or being terminated by the Bank other than cause after the Assuring Period, you will be entitled to the severance/termination package available under your existing employment terms and conditions.

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...

Subject to the above, the terms and conditions of the employment contract between the Bank and [the Employee (the Appellant)] remain unchanged.'

7. The Taxpayer again stated that the Second Supplementary Letter was an attempt by Bank B to maintain the stability of the management team.

8. In December 2000, discussions took place between Bank B and Bank F with respect to an intended takeover or merger. On the 30 March 2001, the Taxpayer received a letter advising him that his employment with Bank B would be terminated with effect from 1 April 2001. Attached to that letter was a computation showing that the Taxpayer would be paid termination payments in a total amount of \$788,214.93 which included the following:

	\$
(a) Payment in lieu of notice (one months' salary, allowance included, if any)	134,080
(b) Termination compensation (five months' salary as stipulated in the Second Supplementary Letter)	514,150
(c) Amount of severance payment (\$22,500 x 2/3 x years of service up to 30-4-2001)	92,589

The law

9. IRO has the following provisions:

Section (8)(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; ...'

Section (9)(1)

'Income from any office or employment includes –

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- (a) *any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others, ...*

Section 68(4)

'The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'

10. We have been referred to and have reviewed various authorities on the question of whether a payment made to an employee upon termination of employment amounts to such income or not.

11. In particular, we refer to D43/93, IRBRD, vol 8, 323, D16/95, IRBRD, vol 10, 144, D90/96, IRBRD, vol 11, 727, D24/97, IRBRD, vol 12, 195, D80/00, IRBRD, vol 15, 715, D107/02, IRBRD, vol 18, 32.

12. The Board in D80/00 helpfully summarized the law in respect of this matter:

' ...

20. *It may be helpful if we were to re-state the principles which we believe should apply in cases where the issue is whether a payment received by an employee upon termination of his employment is taxable under section 8(1) of the IRO. These are derived from the Board's previous decisions:*

- (1) a payment would be taxable if it is in the nature of a gift on account of past services. The word "gratuity" connotes a gift or present usually given on account of past services;*
- (2) a payment made on account of compensation for loss of employment or a payment in lieu of or on account of severance pay is not taxable;*
- (3) it is not the label, but the real nature of the payment, that is important;*
- (4) the way in which the sum in question was arrived at is a material factor in determining the real nature of the payment.'*

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13. We also find the judgment of Lord Wilberforce in Comptroller General of Inland Revenue v Knight [1973] AC 428 at page 20 of assistance:

‘ Questions as to the taxability of payments received by employed persons at the end of their employment have frequently come before the courts: they have often been described as difficult, borderline and depending on narrow distinctions. Two propositions are accepted as common ground in the present case. First, where a sum of money is paid under a contract of employment, it is taxable, even though it is received at or after the termination of the employment ... Secondly, where a sum of money is paid as consideration for the abrogation of a contract of employment, or as damages for the breach of it, that sum is not taxable ...’

Our findings and conclusions

14. We find on the facts that the payment received by the Taxpayer was clearly sourced from his employment. The payment of the sum was specifically provided for under the Second Supplementary Letter. We agree with the submissions by the Commissioner of Inland Revenue’s representative that the sum as stipulated under the Second Supplementary Letter formed part of the remuneration which the Taxpayer was entitled to in respect of his employment with Bank B. The Taxpayer was contractually entitled to this sum and he got exactly what he was entitled to pursuant to his terms of employment.

15. The Taxpayer claimed that the sum was a compensation for the loss of employment. He asserted in his submissions that it was a compensation payment for Bank B’s failure to assure and protect his right of continued employment. However, we conclude that this was not a compensation payment. For something to be a compensation payment, it must be shown that there is a loss or surrender of right on the one side and the legal liability on the other to make the payment. Here, we have the following:

- (a) The Employment Letter was not for a fixed term. It was determinable by either side by giving one month’s written notice.
- (b) Bank B had chosen to terminate the Taxpayer’s employment by giving one month’s salary and allowance as payment in lieu. Bank B was not in breach of the terms of the Employment Letter and the Taxpayer did not have any claim against Bank B.
- (c) The payment of the sum under the Second Supplementary Letter was made without prejudice to any other rights of the Taxpayer. Bank B had duly discharged its obligations to make a severance payment to the Taxpayer. There

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was no evidence that the Taxpayer has surrendered any rights upon his termination of employment which may call for payment of compensation to him.

16. The Taxpayer received what he was entitled to under his contract of employment with Bank B. In our view, the payment that the Taxpayer received was not a compensation for loss of office.

17. For the reasons we have stated above, we would dismiss this appeal.