INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D43/92

Salaries tax – whether payment in lieu of leave assessable.

Panel: Robert Wei Wen Nam QC (chairman), Chen Yuan Chu and Sydney Leong Siu Wing.

Date of hearing: 2 October 1992.
Date of decision: 3 December 1992.

The taxpayer received a payment described as leave pay. He submitted that he did not take annual leave but worked instead and when his employment ceased he received a payment in lieu of leave. He submitted that the payment he received should not be subject to salaries tax.

Held:

The sum paid to the employee had been correctly taxed. The payment was a reward for services and income from employment and liable to assessment to salaries tax.

Appeal dismissed.

Case referred to:

Glynn v CIR [1990] 3 HKTC 245

Maria Tsui for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal by a former employee of a bank (the Taxpayer) against the 1989/90 salaries tax assessment raised on him as revised by the Deputy Commissioner of Inland Revenue in his determination.

2. The Taxpayer was employed by the bank as a contract officer. His employment ceased on 31 December 1989 because of early retirement. His income for the year of assessment 1989/90, as reported by the bank in a notification, was as follows:

		$
(1)	Salary 1 April 1989 to 31 December 1989	266,760.00
(2)	Leave pay	29,022.50
(3)	Annual special payment	29,640.00
(4)	Gratuities 12 September 1955 to 31 December 1989	474,240.00
		$799,662.50

The above items were not in dispute except as to the meaning of 'leave pay'.

3. The assessment in question was raised on the basis that the whole of the sum of $799,662.50 was taxable. The Taxpayer objected on the grounds that the gratuity and leave pay were not taxable because the gratuity was compensation for the loss of his provident fund while the leave pay was compensation for the loss of his annual leave.

4. Having received further information about the gratuity from the bank, the assessor has since conceded that the gratuity was compensation for the loss of employment and therefore was not taxable.

5. The only question for this appeal is whether the payment of the sum of $29,022.50 referred to in 2(2) above as 'leave pay' is assessable to salaries tax.

6. The bank has informed the assessor about the Taxpayer's income for the year in question to the following effect:

(1) Salary $266,760

Paid by autopay. The sum represents monthly salary at $29,640 and was paid monthly.

(2) Leave pay $29,022.50

(a) Exact nature of the amount paid.
Basic salary payment, in lieu of unused annual leave.

(b) Reasons and circumstances leading to the payment.
The Taxpayer was not able to clear his entitled annual leave before his last working day with the bank.

(c) Basis of calculation.

$$\frac{\text{Basic salary}}{24} \times \text{number of unused annual leave days}$$

(d) Details of entitlement to annual leave.
22 working days per annum.

(e) Details of payment.
By autopay on 27 December 1989.

(3) Annual special payment $29,640

(a) Paid by autopay on 12 December 1989.

(b) The bank may, at the discretion of the board of directors, make a special payment equal to one month's basic salary during December of each year to all executives who have completed one calendar year's service. Annual special payments are calculated on basic salaries as at 30 November in the calendar year concerned.

The Taxpayer did not dispute the above information except items (2)(a) and (b).

7. In a letter dated 6 July 1992, addressed to the Deputy Commissioner and copied to the Clerk to the Board of Review, the Taxpayer stated:

> 'I fully agree that leave pay is subject to salaries tax (your determination 3(2) refers). However in my case you have already charged me salaries tax on my leave pay included in my annual income of $296,400 (your determination 1(10) refers) therefore the sum of $29,022 should not be taxed again.
>
> To compensate the loss of my annual leave the bank has to use my basic salary as a factor for the calculation. Annual leave pay should not be taxed twice. No matter at what angle I look at I still feel the sum of $29,022 paid to me by the bank is a compensation for the loss of my annual leave and not a payment of leave pay twice.'

8. The grounds of appeal filed by the Taxpayer on 9 July 1992 were as follows:

'(1) Inland Revenue Department have already charged me salaries tax on my leave pay which was included in my annual income of $296,400.

(2) The sum of $29,022 the bank paid me is a compensation for my annual leave the bank have taken away from me.

(3) The bank has to use my basic salary as a factor to calculate the compensation due to me.'

9. The relevant provisions of the Inland Revenue Ordinance (the IRO) are as follows:

> '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; and
>
> (b) any pension.
>
> 9(1) 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 …'

10. The first ground of appeal (see 7(1) above) rests on the proposition that the leave pay of $29,022 was included in the annual income of $296,400 which has already been taxed. It is common ground that the sum consists of (1) nine months' salary totalling $266,760 (see 2(1) above) and (2) annual special payment of $29,640 which was a payment of bonus equivalent to one month's salary for completing one calendar year's service; therefore the income of $296,400 is three months' salary short of annual income. However, this is a mere matter of nomenclature. We take the Taxpayer's case to be this: in respect of the relevant year he was entitled to annual leave together with leave pay; the leave pay was included in the income of $296,400 which has been taxed; therefore he must have already paid tax on the leave pay; therefore the $29,022 payment (see 2(2) above) cannot have been leave pay, because otherwise he would have been taxed twice in respect of leave pay; it follows (here the argument leads to the second ground of appeal set out in 8(2) above) that the payment was compensation for the loss of annual leave and therefore not taxable. It is common ground that the Taxpayer had not taken his annual leave before his employment ceased on 31 December 1989; we also accept (it was in fact not disputed) that it was at the bank's request that the Taxpayer did not take annual leave but worked instead. The third and last ground (see 8(3) above) takes the point that in calculating the compensation the bank used the basic salary as a factor; it was not in dispute that the basic salary was used as a factor in calculating the $29,022 payment, although the bank called it basic salary payment in lieu of unused annual leave (see 6(2)(a) above).

11. The central question of the Taxpayer's argument is whether leave pay was included in the $296,400 income. In our view, the answer must be no. 'Leave pay' is not defined; we take the view that leave pay is salary for the leave period; it provides the employee with a means of support when he goes on leave; we find support for our view in P G Willoughby's Hong Kong Revenue Law, [1991], vol 2, 2-123 where it states that the general principle is that the employee becomes entitled to leave pay when he goes on leave; there is nothing in this case to displace that general principle. Since the Taxpayer did not

take his annual leave, leave pay was not payable, nor could it form part of the $296,400 income. The reality of the situation, as we find it, was this: the Taxpayer worked throughout the first nine months of the financial year and was paid nine months' salary plus an extra month's salary by way of bonus; at the bank's request, the Taxpayer was forgoing his annual leave and the leave pay that went with it; in return the bank paid him the sum of $29,022 which was equivalent to the leave pay; as a substitute for the leave pay, it put the Taxpayer in funds if he wished to take a holiday of the same duration as the annual leave. In our view, it would be idle to ignore the leave pay angle and focus on the annual leave and insist that the $29,022 payment was compensation for the loss of annual leave, for that would leave the leave pay unaccounted for, and it would be absurd to suggest that there should be another payment of $29,022 to cover the leave pay. Leave pay is a reward for services; that is why, we think, it is income from employment under section 9(1)(a). As a substitute for leave pay, the $29,022 payment was in our view also a reward for services and income from employment and taxable as such. Payments of this nature (often called payments in lieu of leave) should be distinguished from compensation for the loss of employment which is not taxable as income from employment because the employment has been terminated and the compensation, the income, cannot be said to arise from it.

12. That disposed of this appeal. However, we think we should deal with the submissions made by Miss Tsui, the Deputy Commissioner's representative on the question of perquisites. Her point was that the $29,022 payment was a perquisite within the meaning of section 9(1)(a) on the ground that it was 'money paid to the employee', relying on Glynn v CIR [1990] 3 HKTC 245 at 250. The Privy Council based their interpretation of 'perquisite' on the United Kingdom Income Tax Act 1842; the judgment states at 248:

> 'By the United Kingdom Income Tax Act 1842, income tax was charged under schedule E on all salaries, fees, wages, perquisites or profits whatsoever accruing by reason of inter alia employment of the taxpayer. Perquisites were deemed to be such profits of offices and employments as arise from fees or other emoluments and payable either by the Crown or the subject in the course of executing such offices or employments …'

It is thus clear that to amount to a perquisite, the payment must be payable in the course of executing the employment. 'Perquisite' in section 9(1)(a) should be construed in the same way. The judgment states at 252:

> '… in the present case their Lordships consider that perquisites not expressly exempted from salaries tax under the Hong Kong Ordinance are no different from perquisites not exempted from tax under the Income Tax Act.'

The question is therefore whether the $29,022 payment was payable in the course of executing the employment. As a reward for services, we think it was so payable and was therefore a perquisite within the meaning of section 9(1)(a).

13. This appeal is dismissed and the revised assessment in question is hereby confirmed.

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