

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D51/01

Salaries tax – additional assessment – gratuity payment – refinance of mortgage – sections 8(1), 9(1) and 68(4) of the Inland Revenue Ordinance (‘IRO’) – sections 31I, 31IA and 31G of the Employment Ordinance (‘EO’).

Panel: Patrick Fung Pak Tung SC (chairman), Paul Chan Mo Po and David Wu Chung Shing.

Date of hearing: 12 February 2001.

Date of decision: 9 July 2001.

The taxpayer’s case was that the part of the 25% gratuity in the total sum of \$175,100.73 which amounted to \$31,200 was in effect severance payment which he was entitled to claim from his employer under the EO. The said part of the gratuity in the sum of \$31,200 should therefore be exempted from salaries tax.

The Commissioner’s case was that the gratuity paid to the taxpayer in the rounded-off sum of \$175,101 was a contractual gratuity and not a severance payment paid under the EO and the same would not be exempted from salaries tax.

Held:

1. It is settled law that labels such as ‘gratuity’ or ‘severance payment’ are not conclusive. One must look at the terms of the contract and the character of a payment made under it in order to determine the true nature of such payment D90/96, IRBRD, vol 11, 727 and D24/97, IRBRD, vol 12, 195 considered and applied).
2. Having considered the terms of the Agreement (together with the appendix thereto), the Board had no doubt that the 25% gratuity was part of the remuneration and reward paid to the taxpayer for his service for the full period of the contract of employment as subsequently extended. The said sum of \$175,101 was in law and in fact the taxpayer’s income (that is, ‘gratuity’ or ‘perquisite’) arising in or derived from Hong Kong from his office or employment of profit. It was not wholly or partly a severance payment or long service payment made to him under the EO (Encyclopaedia of Hong Kong Taxation Volume 3 at paragraph 3288 on page II 711 considered).

Per Mr David Wu Chung Shing (dissenting):

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Based on the wordings, rationale and ‘ spirit’ of sections 31I and 31IA of the EO, the present case fits perfectly into section 31IA of the EO for tax assessment apportionment purpose and not section 31I of the EO.

Appeal dismissed.

Cases referred to:

D90/96, IRBRD, vol 11, 727
D24/97, IRBRD, vol 12, 195
Chibbett v Robinson (1924) 9 TC 48
Hunter v Dewhurst (1932) 16 TC 605
Henley v Murray [1950] 1 All ER 908
D24/88, IRBRD, vol 3, 289
D15/93, IRBRD, vol 8, 350
D38/94, IRBRD, vol 9, 264
D32/95, IRBRD, vol 10, 195

Chu Wong Lai Lun for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

A: Majority decision

1. This is an appeal by the Taxpayer against a notice of assessment and demand for salaries tax for the year of assessment 1997/98 (‘ the Assessment’) issued by the Commissioner on 12 October 1998. An objection was lodged by the Taxpayer against the Assessment.
2. By his letter dated 31 October 2000, the Commissioner made a determination and rejected the Taxpayer’s objection. Under the Assessment, the amount of tax originally assessed to be payable was \$64,611. In the same letter, the Commissioner revised the figure upwards to \$66,346 to take into account the gratuity paid to the Taxpayer for his outstanding leave. The calculation regarding this aspect is set out in paragraph (14) of the Commissioner’s letter.

The facts

3. The Taxpayer gave evidence on affirmation. Although he was cross-examined by Mrs Chu for the Commissioner, the basic facts do not appear to be in dispute.

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4. The Taxpayer was employed by a company called Company A as an assistant inspector of works in relation to a project on Road B under an agreement intituled ‘ Hong Kong Government Schemes Local Resident Site Staff Agreement’ dated 2 January 1996 (‘ the Agreement’).

5. Clause 4 of the Agreement read as follow:

‘ THIS Agreement is subject to the conditions set forth in the Appendix hereto annexed and the Appendix shall be read and construed as part of this Agreement’

6. Paragraph 3 of the appendix provided that the Taxpayer was appointed on a temporary basis nominally for a period of about 21 months.

7. Paragraph 10 of the appendix provided that the question of sick leave should be dealt with in accordance with the EO.

8. The relevant part of paragraph 15 of the appendix read as follows:

‘ 15. On satisfactory completion of the full period of this Agreement or if the service of the person engaged is terminated under Clause 10 or Clause 11.4 the person engaged will be eligible for a gratuity equivalent to 25% of gross basic salary drawn during the period of engagement ...’

9. By a letter dated 25 July 1997, Company A advised the Taxpayer that the Agreement was due to expire on 2 October 1997 and that it intended to extend his terms of employment to 31 January 1998. It further stated that the terms and conditions of the extended employment contract would be the same as those in the Agreement. With regard to the gratuity, he would receive his 21 months’ gratuity with his October payroll subject to his satisfactory completion of service. The Taxpayer countersigned this letter to indicate his acceptance thereof.

10. On 9 January 1998, Company A paid the sum of \$137,897.98 to the Taxpayer being the 25% gratuity for the period between 2 January 1996 and 1 October 1997.

11. By a letter dated 27 January 1998, Company A informed the Taxpayer that his employment contract was due to expire on 31 January 1998 and that it was unable to extend his contract beyond this date. It further informed him that he had approximately 39.5 days of outstanding leave prior to 31 January 1998 and that it would pay him ‘ in lieu’ once it received payment from its client.

12. On 25 March 1998, Company A paid the sum \$27,565.89 to the Taxpayer, being 25% gratuity for the period between 2 October 1997 and 31 January 1998.

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13. On 11 December 1998, Company A paid the sum of \$9,636.86 to the Taxpayer, being the 25% gratuity for his outstanding leave up to 31 January 1998.

14. In a letter dated 10 July 2000 written by Company A in answer to queries made by the Inland Revenue Department, Company A said the following:

(8) No severance payment was made to the Taxpayer because he was on a fixed contract with a gratuity. Under the Employment Ordinance, the gratuity can be set-off against the severance payment, see attached extract. The calculation is shown below:

Severance payment:

$$\$22,500 \times 2.08 \text{ years} \times 2/3 = \$31,200.00$$

Gratuity

$$\$137,897.98 + \$27,565.89 = \$165,463.87$$

The gratuity payment exceeds the severance payment and therefore no additional amount is due.'

15. The Commissioner has a declared policy and an established practice that no salaries tax will be assessed and demanded on severance payments made in accordance with the EO.

The case of the Taxpayer

16. The case of the Taxpayer can be summarised as follows:

- (i) Although Company A was acting as an agent of the Government, as a matter of law and fact, the Taxpayer was employed by Company A and not by the Government.
- (ii) The EO applied to his employment by Company A.
- (iii) That part of the 25% gratuity in the total sum of \$175,100.73 referred in paragraphs 10, 12 and 13 above which amounted to \$31,200 was in effect severance payment which he was entitled to claim from Company A under the EO.
- (iv) The said part of the gratuity in the sum of \$31,200 should therefore be exempt from salaries tax.

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The case of the Commissioner

17. Originally, the Commissioner based his determination on the following reasons:
- (i) Company A was acting as the Government's agent when it employed the Taxpayer. By virtue of section 66 of the Interpretation and General Clause Ordinance (Chapter 1), the EO did not bind the Government and therefore did not apply to the employment contract of the Taxpayer.
 - (ii) In any case, the gratuity paid to the Taxpayer in the rounded-off sum of \$175,101 was a contractual gratuity and not a severance payment paid under the EO and the same would not be exempted from salaries tax.
18. At the hearing of the appeal and for the purpose of the appeal, the Commissioner conceded that the Taxpayer was employed by Company A rather than the Government during the relevant period and that the provisions of the EO were applicable.
19. Hence, only the second point raised by the Commissioner remained in issue between the parties.

Our conclusion

20. Section 8 (1) of the IRO provides as follows:
- '(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.'*
21. The relevant part of section 9(1) of the IRO provides as follows:
- '(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...'*
22. It is settled law that labels such as 'gratuity' or 'severance payment' are not conclusive. One must look at the terms of the contract and the character of a payment made under

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it in order to determine the true nature of such payment. See decisions of the Board in D90/96, IRBRD, vol 11, 727 and D24/97, IRBRD, vol 12, 195.

23. Having considered the terms of the Agreement (together with the appendix thereto), we have no doubt that the 25% gratuity was part of the remuneration and reward paid to the Taxpayer for his service for the full period of the contract of employment as subsequently extended. The said sum of \$175,101 was in law and in fact the Taxpayer's income (that is, 'gratuity' or 'perquisite') arising in or derived from Hong Kong from his office or employment of profit. It was not wholly or partly a severance payment or long service payment made to him under the EO.

24. Furthermore, section 31I of the EO reads as follows:

' 31I. Severance payment to be reduced by amount of gratuities and benefits in certain cases

If an employee becomes entitled to payment of the severance payment under this Part and –

(a) because of the operation of the employee's contract of employment, one or more gratuities based on length of service or one or more relevant occupational retirement scheme benefits have been paid to the employee; or

(b) a relevant mandatory provident fund scheme benefit is being held in a mandatory provident fund scheme in respect of the employee,

the severance payment is to be reduced by the total amount of all of the gratuities and benefits to the extent that they relate to the employee's years of service for which the severance payment is payable.'

25. The effect of the said section 31I is that if, as in this case, the employee receives a gratuity under the terms of his contract of employment which is based on the length of service and the amount of such gratuity exceeds the amount of any severance payment he would have been entitled to under the formula set out in section 31G of the EO, then such severance payment is reduced to nil.

26. There is no dispute that any severance payment calculated in accordance with the said section 31G would be less than the gratuity of \$175,101. See paragraph 14 above.

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27. Hence, despite his length of service, any entitlement of the Taxpayer to severance payment under the EO would have been reduced to zero because of the gratuity he was receiving under the terms of the Agreement.

28. It may perhaps be argued by the Taxpayer that if Company A had not inserted the gratuity provisions in the Agreement (by reference to the appendix annexed thereto), then he would have been entitled to claim severance payment from Company A under the EO and the same would have been exempt from salaries tax. Be that as it may, first, the severance payment which he would have been entitled to claim under the EO would have been less than the sum of \$175,101 and, secondly, it is clear that the exemption granted by the Commissioner only relates to severance payments made in accordance with the EO and not to a payment specified as part of a pay package under a contract employment. It is trite that taxpayers can legitimately carry out tax-planning by effecting a transaction in one way as opposed to some other way so as to avoid tax liability.

29. We have read in draft form the dissenting decision of Mr David Wu Chung-shing and are aware of the point he has made on section 31IA of the EO. With the greatest respect to Mr Wu, we do not feel able to agree with his view for the reasons set out below.

30. First, although section 31IA seems to be the other side of the coin of section 31I, basically they are provisions in the EO which regulate the relationship between an employer and an employee and are made to ensure that an employer is not obliged to make double payment for the same thing. At the end of the day one still has to look into the true nature of the payment. There is no doubt that, in the present case, the payment in question was part of the pay package agreed between Company A and the Taxpayer at the commencement of the employment (as an inducement to the Taxpayer to take up the employment) which became payable without any breach on the part of Company A.

31. Further, our view appears to be supported by certain passages in the Encyclopaedia of Hong Kong Taxation Volume 3. At paragraph 3288 on page II 711, it is said:

‘ [3288]

The general rule is that sums paid either on the premature termination by an employee of an office or employment or in consideration of a variation of the terms of employment are exempt because they flow from the breach of contract and not from the employment itself (see Chibbett v Robinson (1924) 9 TC 48; Hunter v Dewhurst (1932) 16 TC 605; Henley v Murray [1950] 1 All ER 908). Presumably for this reason the Commissioner accepts that redundancy payments and long service payments made under the terms of the Employment Ordinance (Chapter 57) are not taxable (see, for example, D24/88, IRBRD, vol 3, 289; D15/93, IRBRD, vol 8, 350 and D38/94, IRBRD, vol 9, 264)’

At paragraph 3331 on page II 757, it is said:

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‘ [3331]

Rather than adopt a strict rule as the Board apparently did, perhaps a better approach, and one supported by authority, is to see in each individual case what the payment was made for. The key to salaries tax liability is the nature of the payment and whether it is made in return for acting as or being an employee. While in most cases, a lump sum payment other than one in lieu of notice or from a recognised occupational retirement scheme will be taxable on the basis of established authorities, one can envisage other types of payment should not be subject to salaries tax, eg redundancy payments made by an employer to an employee who is “encouraged” to resign rather than continue working up to normal retirement age ...’

32. We appreciate that Mr Wu places a lot of reliance on the concessions made by the Commissioner at the hearing, especially the concession in paragraph 24 of the written submission of his representative. Read in its context, we take the view, however, that that concession was to the effect only that the Taxpayer would have been entitled to severance payment on completion of his extended employment on 31 January 1998 but for the operation of section 31I of the EO. It therefore is of no assistance to the Taxpayer.

33. Section 68 (4) of the IRO provides that at an appeal to the Board:

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

We are not satisfied that the Taxpayer has discharged his onus.

34. In the result, we dismiss the Taxpayer’s appeal by a majority.

B: Dissenting opinion of Mr David Wu Chung Shing

35. This is a case of tax assessment dispute on severance payment and gratuity. The facts, as stated, are not in dispute.

36. The case of the Taxpayer (outlined in paragraph 16 of the majority Board decision) and the case of the Commissioner (outlined in paragraphs 17,18 and 19) are clear.

37. My contentions, hence my dissent, rest on the following facts and personal opinion from a layman’s point of view:

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- a) The Taxpayer had met all the conditions of section 31B of the EO and was entitled to statutory severance payment (referred to hereafter as ‘ Severance pay A’) under section 31G of the EO or \$31,200 in this case.
- b) Therefore, on 31 January 1998 upon the completion of the 25 month contract, the total amount, \$165,463.87* paid or payable to the Taxpayer under the contract gratuity terms (referred to hereafter as ‘ gratuity B’) were, for tax assessment purpose, subject to apportionment in accordance with section 31I or 31IA of the EO, the twin ‘ set-off’ sections in the statutory EO.
- c) The Revenue and the majority Board decision appear to subscribe at least in part to the above contentions, but they both chose to apply the formula of section 31I of the EO, which reduces ‘ Severance pay A’ to a negative sum (hence ‘ nil’).
- d) Based on the wordings, rationale and ‘ spirit’ of sections 31I and 31IA of the EO, I have no doubt that the present case fits perfectly into section 31IA of the EO for tax assessment apportionment purpose, and not section 31I of the EO.

38. It is agreed that under section 9(1) of the IRO, a non-exhaustive definition of income, technically severance pay, being income derived from office or employment, is taxable. It is however the practice of the Revenue not to tax severance payments made under the provisions of the EO (‘ Severance pay A’). This practice has been repeatedly confirmed by the Revenue and stated in many previous Board cases, including the present one.

39. It is also agreed that the Commissioner has the right to deviate from the norm practice of not taxing ‘ Severance pay A’ , one example of which is any case involving Government employees since the ‘ EO is not binding on the Government’ . However, the Commissioner’s right to deviate from the norm practice must surely be exercised only in cases of exceptional, unmitigating circumstances. Otherwise, such act would violate both the substance and the spirit of the EO.

40. None of the Board case cited (D90/96, D24/97, D24/88, D15/93, D32/95, IRBRD, vol 10, 195) fit 100% into the present case to form a precedent. As mentioned above, they all reconfirmed that ‘ Severance pay A’ , once accepted as such, was not taxable. Perhaps for this simple reason, there has not been a Board case of dispute on the correct applicability of section 31I or 31A of the EO. We are asked here to decide and set a precedent on this technical but important issue.

41. As rightly expounded in paragraph 22 of the majority Board decision, ‘ gratuity’ and ‘ severance payments’ and ‘ labels’ subject often to misuse, confusion and dispute. However, ‘ Severance pay A’ , statutory and fixed in amount to the last cent by section 31G of the EO is always identifiable and distinct from any other form of severance payments and gratuity.

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42. Paragraph 23 of the majority Board decision states that the original fixed 21-month employment contract between the Taxpayer and the employer Company A plus the subsequent four-month extension specified only contractual 'gratuity' or 'perquisite' with no element of severance pay included. The fact is, upon completion of the whole 25-month contract (a lucky break for the Taxpayer as the four-month extension had not been contemplated in the original 21-month contract) and as conceded by the Revenue, the Taxpayer became eligible for 'Severance pay A' under section 31B of the EO (see paragraph 24 of the Revenue's final submissions, detailed later under my paragraph 16).

43. In the various arguments and supporting materials provided by the Taxpayer and the Revenue on the issue of gratuity and 'Severance pay A', the following three excerpts (paragraphs 10, 11 and 12 below) deserve due attention and consideration.

44. In 'Reasons therefore' under the Commissioners original 31 October 2000 determination, after laboriously arguing the focal point of the Revenue's case then that the Taxpayer was a Government employee hence not subject to EO application, paragraph 8 stated:

' The Labour Department's letter at appendix F submitted by the Taxpayer is irrelevant. There is no evidence that the facts of the case and the present one are on all fours. The Labour Department confirms that the EO is not binding on the Government. In this connection, there is no obligation on the Government to make severance payment under EO. Neither section 31I nor section 31IA of the EO is applicable. Hence there is no question of gratuity being reduced by any severance payment or vice versa.'

It appears logical to say that the Labour Department's letter on the issue became relevant and that the 'set-off' section 31I or 31IA of the EO was applicable upon Revenue's later concessions on the 'Government employee' and 'entitlement to Severance pay A' issues.

45. The Commissioner of Labour's letter of 19 November 1997 under the heading 'Enquiry on Severance Payment' at appendix F restated the conditions for 'Severance pay A' eligibility under the EO, namely the employee 'must have worked under the employer for a period of not less than 24 months' and 'must either be dismissed by reason of redundancy or layoff'.

Furthermore, 'if you were dismissed by the employer because your fixed term contract expired without being renewed and there was no replacement to your post, it appears that you are eligible for the Severance payment under the Employment Ordinance.'

Lastly, 'with regard to the gratuities you received, your attention is drawn to Section 31IA of the EO which states that if an employee is entitled to gratuities for all the years of service which a severance payment is payable, such gratuities shall be reduced by the severance payment paid to him.'

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It appears that the substance of this letter, whether it is right or wrong, could apply equally to the present case of a similar nature. The letter is pertinent to this case.

46. The Revenue's 26 June 2000 letter to the employer Company A, after querying about the 'government employee' issue in paragraphs 1 to 7 – the focal point of the Revenue's case then – the assessor (appeals) asked, in the last paragraph 8:

' The Employment Ordinance (' the EO') provides that where an employee who has worked under a continuous contract with the employer for a period of not less than 24 months and is dismissed, he is eligible for severance payment under the EO. The EO further provides that dismissal is to embrace the situation where the employee's fixed term contract expired but without being renewed and there is no replacement to the employee's post. Applying the above requirements to the Taxpayer's case, it appears to me that he could be eligible to severance payment. Please confirm whether severance payment has been paid to the Taxpayer and if no, please explain the reasons why you consider the EO was not applicable in the Taxpayer's case' .

This clearly refutes the contention that the employment contract concerned here automatically excludes the existence and inclusion of any statutory ' Severance pay A' under the contract gratuity payments (see majority Board opinion paragraph 23).

47. Now comes the crux of the matter: which is the correct EO ' offset' section to apply in the present case. Is it section 31I of the EO? Or section 31IA of the EO? In my layman's opinion, sections 31I and 31IA of the EO are complementary sections with each covering ' one side of the same coin' . It appears that the law-framers of the EO had wisely foreseen the confusion that might arise on ' offsets' between ' Severance pay A' and contract gratuity (' gratuity B') and therefore inserted the two sections to resolve or preempt any dispute on the above question.

48. Section 31I of the EO provides ' set-off' of gratuity payment specified under contract (' B') against statutory ' Severance pay A' . It in fact says that when ' Severance pay A' is greater than ' gratuity B' , actual ' Severance pay A' is reduced to A-B. The Taxpayer still receives in total the greater sum ' A' under the formula $(A-B)+B=A$. The taxable contract ' gratuity B' remains the same. The non-taxable ' Severance pay A' under the EO is now A-B.

By common logic, the use of the word ' set-off' and the presence of the complementary section 31IA of the EO that immediately follows, section 31I of the EO, for any purpose, could only be meant to apply to cases where ' Severance pay A' is greater than ' gratuity B' . To interpret of apply differently, one would reach some irrational or weird results, as to be seen in this case.

49. Section 31IA of the EO provides ' set-off' of Severance payment (' A') against gratuity payment under contract (' B'). It in fact says: if ' gratuity B' is greater than ' Severance pay A' , then actual contract gratuity is reduced to B-A. The Taxpayer still receives the greater sum

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‘ B’ under the formula $(B-A)+A=B$. The taxable actual ‘ gratuity B’ is now reduced to $(B-A)$. The non-taxable ‘ Severance pay A’ remains the same.

Section 31IA of the EO, the complementary ‘ other side of the same coin’ to section 31I of the EO, could only be meant to apply to cases where contract ‘ gratuity B’ is greater than EO ‘ Severance pay A’. And I submit that the present case fits into section 31IA of the EO in every respect – a perfect match.

50. Paragraph 24 of the Revenue’ s final submissions made at the Board hearing began:

‘ For purpose of this appeal, the Revenue concedes that the Taxpayer was entitled to severance payment when the Taxpayer completed the extended term of employment on 31 January 1998’ .

In fact the Revenue now admits that there was only one contract (the original 21 months plus the four-month extension) and therefore upon its completion the Taxpayer was eligible for all EO provisions including ‘ Severance pay A’ and ‘ Severance pay A/Contract gratuity B’ set-off.

Furthermore, logically all calculations concerned should be based on the total sum, whether parts of which had already been ‘ advanced’ or other parts still payable, due to the Taxpayer contractually and legally on 31 January 1998. Any technical arguments based on separate, piecemeal sums paid or payable, before or after, are immaterial and irrelevant for the purpose of this appeal. One cannot eat the cake and have it too.

51. Both the Revenue and the majority Board decision (possibly following the employer Company A’ s calculations) have chosen section 31I of the EO as the relevant ‘ set-off’ section under which:

Severance pay A	$\$22,500 \times 2.08 \text{ years} \times 2/3$	=	\$31,200
Less: Contract gratuity B	$\$137,897 + \$27,565.89$	=	\$165,463.87*
Hence: Net amount of severance pay A due under section 31I of the EO			Nil

(* Different gratuity figures were mentioned by Revenue and the majority Board decision. I have used the figure of \$165,463.87 stated by the employed Company A in its 10 July 2000 letter – anyway, the actual ‘ gratuity B’ amount is only a secondary issue here so long as ‘ gratuity B’ is greater than ‘ Severance pay A’).

52. With all due respect, I strongly submit that both the Revenue and my distinguished Board colleagues were wrong in choosing section 31I of the EO as the set-off section (see my paragraph 14), thus reaching a mathematically negative ‘ Severance pay A’ sum. Furthermore, they have ignored entirely the complementary set-off section 31IA of the EO (see my paragraphs 15) which seems ‘ tailor made’ for the present case.

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53. The Taxpayer apparently understood the correct 'set-off' issue and contended:

' I agree that part of my gratuity is taxable under section 8 and section 9 of the Tax Ordinance, however it is also clear that part of my gratuity should be set-off by the severance payment in accordance with the Employment Ordinance. It appears to me that you are deliberately ignorant of the interpretation of Labour Department and the relevant section 31IA of the EO, in which part of my gratuity clearly falls within the meaning of severance payment.' (quoted in fact 15 of the original Commissioner's determination).

54. I agree with the Taxpayer's above contention based on actual facts and after the major concessions subsequently made by the Revenue at the hearing:

- a) that the Taxpayer was not a Government employee;
- b) that there was only one 25-month continual contract;
- c) that upon completion of the contract on 31 January 1998 the Taxpayer was entitled to EO 'Severance pay A' ;
- d) that some form of 'offset' under the EO was applicable (note: the Revenue chose the 'wrong' section 31I of the EO instead of section 31IA of the EO).

55. Finally, the Revenue and the majority Board decision appear to rely heavily on the employer Company A's 10 July 2000 letter of reply to the Revenue's 26 June 2000 letter of enquiry (see paragraph 12 above). For easy reference, the excerpts concerned and stated in the majority Board decision are repeated here:

' (8) No severance payment was made to the Taxpayer because he was on a fixed contract with a gratuity. Under the Employment Ordinance, the gratuity can be set-off against the severance payment, see attached extract. The calculation is shown below:

Severance payment	:	$\$22,500 \times 2.08 \text{ years} \times 2/3$	=	\$31,200
Gratuity	:	$\$137,897.98 + \$27,565.89$	=	\$165,463.87*

The gratuity payment exceeds the severance payment and therefore no additional amount is due.'

56. The employer Company A was answering the Revenue's (assessor-appeals) letter (see my paragraph 12). In fact the succinct and forthright answers should be read and considered as follows:

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- a) The first sweeping sentence was obviously wrong (no ill intention meant I am sure): A fixed contract with a gratuity does not exclude ‘Severance pay A’ if the Taxpayer was eligible to EO rights.
- b) Company A then somewhat retracted or ‘corrected’ itself by justifying the ‘no severance payment’ under section 31I of the EO (the wrong ‘set-off’ section).
- c) Company A’s last sentence, in my layman’s understanding, said that though the Taxpayer was entitled to the \$31,200 ‘Severance pay A’, ‘no additional amount’ was due since this \$31,200, being of a smaller amount, had already been included in the gratuity payment of \$165,463.87. This explanation or interpretation seems both logical and in substance consistent with the correct ‘set-off’ section 31IA of the EO in every respect.

Conclusion

57. After consideration of the facts and arguments and with the ‘last-minute’ major concessions made by the Revenue, I find that the Taxpayer has discharged his onus and is entitled to all EO rights, including the correct tax assessment on contract gratuity and EO severance payment calculations set out in section 31IA of the EO as below.

58. Of the total sum concerned and received (or receivable) by the Taxpayer – \$165,463.87* – upon contract completion on 31 January 1998: \$31,200 was his statutory severance pay entitled under the EO, and \$134,263.87 was his actual gratuity (contract gratuity \$165,463.87* reduced or offsetted by the statutory EO severance pay \$31,200).

59. Based on all the facts, I cannot find any justification or exceptional circumstance in this case for the Commissioner to deviate from the norm practice of not taxing statutory severance pay under the EO.

60. Therefore, the Taxpayer’s appeal should be allowed and the tax assessment on the \$31,200 statutory EO severance pay portion should be withdrawn.