

Case No. D52/05

Salaries tax – whether payment a sum arising upon termination of employment – salary reduction – whether salary reduction supported by consideration – whether discharged burden to prove that payment formed part of entitlement on termination – whether ‘gift’ or ‘gratuity’ under section 9(1)(a) of the Inland Revenue Ordinance (‘IRO’).

Panel: Kenneth Kwok Hing Wai SC (chairman), Clement Chan Kam Wing and Marvin Chen.

Date of hearing: 1 September 2005.

Date of decision: 18 October 2005.

In October 2003, the appellant earned a monthly salary of HK\$73,390. On 16 October 2003, the appellant accepted a reduction in salary to HK\$50,000 effective from 1 November 2003.

By letter dated 20 February 2004, the employer informed the appellant that her employment would be terminated with effect from 1 March 2004. As part of her redundancy package, the appellant was offered, inter alia, an additional sum which constituted the difference between HK\$73,390 and HK\$50,000 for the period between 1 November 2003 and 31 January 2004.

The issue before the Board was whether the sum of HK\$93,650 arose from termination of employment and should not be subject to salaries tax. This sum represented the difference between the appellant’s original and reduced salary for the period between 1 November 2003 and 29 February 2004. The appellant did not give evidence at the hearing.

Held:

1. Under sections 8(1) and 9(1)(a) of the IRO, in order for a payment to be liable to salaries tax, it must arise from the employment, be referable to services which the taxpayer rendered by virtue of his office, and must be something in the nature of a reward for services past, present or future. D60/97 applied.
2. The agreement for a reduction of salary was not supported by consideration. The Board refused to attach any weight to the assertion, which was not supported by evidence, that the appellant would be dismissed if she refused to agree to the salary

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reduction. It was questionable whether the agreement was binding on her in law in view of her contractual entitlement to a higher salary.

3. If the agreement was not binding, the appellant was contractually entitled to be paid HK\$93,650 for the four month period. Accordingly, the payment would have satisfied the test set out in D60/97 and be liable to salaries tax.
4. On the other hand, if the agreement was binding on the appellant, she would have no contractual entitlement to the payment. The appellant made no attempt to show that the payment formed part of her entitlement under the employer/employee legislation on termination of employment. Thus, the payment was in the nature of a gift or gratuity which is expressly included under section 9(1)(a) as income liable to salaries tax.

Appeal dismissed.

Case referred to:

D60/97, IRBRD, vol 12, 367

Taxpayer represented by her husband.

Poon So Chi and Tsui Siu Fong for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal against so much of the determination of the Deputy Commissioner of Inland Revenue dated 17 June 2005 which reduced salaries tax assessment for the year of assessment 2003/04 under charge number 9-1578860-04-4, dated 19 November 2004, showing net chargeable income of \$641,226 with tax payable thereon of \$107,901 to net chargeable income of \$632,057 with tax payable thereon of \$106,205.

The relevant facts

2. The appellant objected to the salaries tax assessment for the year of assessment 2003/04 raised on her and claimed that the sum of \$93,560 received from her former employer upon termination of employment should not be subject to salaries tax.

3. On 22 August 1989 the appellant commenced her employment with a company. Following the acquisition of that company by her former employer's group, the appellant was

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transferred to her former employer on 1 September 1999. The former employer changed its name twice.

4. The letter of appointment dated 31 August 1999 issued by the former employer provided, among others that:

‘ After 4 June 2001 severance entitlements upon termination of employment will be determined by the redundancy policy of the employer in force at the time.’

5. By October 2003, the appellant’s monthly salary was \$73,390.

6. By letter dated 15 October 2003 the former employer wrote to the appellant as follows:

‘ Due to the unsatisfactory result of the ... business in the past couple of years, as the senior management of the Company, we have to take whatever appropriate measures to turn the result of the Company around as soon as possible. As such, the Company has come to a painful decision to adjust your monthly salary with effect from November, 2003. In this regard, please be informed that your basic monthly salary will be adjusted from HK\$73,390 to HK\$50,000 with effect from 1 November 2003. Notwithstanding this adjustment, your functional title as Director, ... Sales and all of the other terms and conditions of your employment will remain unchanged.

Please sign both copies of this letter and return the duplicate to us as confirmation of your agreement to and acceptance of these revised terms of your employment. Should you have any questions, please feel free to discuss with me.’

The appellant countersigned on the duplicate dated 16 October 2003 indicating her agreement and acceptance.

7. By two letters dated 16 February 2004 and 19 February 2004, the former employer wrote to the appellant on termination of the appellant’s employment. These two letters were superseded by the former employer’s letter dated 20 February 2004 which read as follows:

‘ Further to the meetings on 16 February, 2004 and 18 February, 2004 between you and your supervisor regarding your redundancy arrangement, we are pleased to set out the following terms of your redundancy package. Please note that the terms set out in this letter supersede the terms contained in our previous letter of 16 February, 2004 to you.

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Your position will be made redundant with effect on and from 1 March, 2004. As a result, you will be compensated in accordance with the following terms. We would like to draw your attention that although your current basic monthly salary is HK\$50,000, however, in appreciation of your long years of service with the Company, we shall use your basic monthly salary before your salary reduction in November 2003 [‘Enhanced Salary’] i.e. HK\$73,390 as the basis for calculating your compensation. Details of the terms are as follows:

- a) An amount equivalent to one month of the Enhanced Salary as payment in lieu counted for the period from 1 March, 2004 to 31 March, 2004 (both dates inclusive). Your benefits entitlement will be terminated with effect from 1 March, 2004.
- b) As mentioned previously, in appreciation of your long service with the Company, we are prepared to pay you an additional sum calculated as the difference between the Enhanced Salary and your current basic monthly salary for the period from 1 November, 2003 to 31 January, 2004 [‘Sum’]. In addition to that, we are also prepared to make a one-time contribution to your employer contribution account of the retirement benefits provided to you by the Company. Such contribution is calculated at 15% on the said Sum.
- c) An amount of payment for your annual leave balance that has been accrued but not yet taken, up to and including 29 February, 2004.
- d) An amount of severance payment to be calculated in accordance with the applicable provisions of the Employment Ordinance of Hong Kong. Your year of service will be counted from 22 August, 1989 to 29 February, 2004. Please note that in accordance with the relevant provisions of the Employment Ordinance and the MPFS Ordinance of Hong Kong, this severance payment will be offset against that part of your accrued benefits held in the retirement scheme set up by the Company, which is attributable to contributions paid to the scheme by the Company.

...

You acknowledge and accept that upon receiving payment [‘Payment’] from the Company in settlement of your above redundancy package, the Company shall be absolved and released from any obligations or liabilities for any claims or actions that may be instituted by you, your agents/representatives or any other persons/entities connected with you and on your behalf in connection with your employment and the termination thereof. As regards details of calculation of the Payment, we will let you have a copy of the calculation on the last day on which you leave the Company.

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On behalf of the Company, we would like to thank you for your contributions made in the past. In the meantime, we ask for your cooperation to hand over any tasks on hand to your Supervisor directly.

May we wish you every success in your job search and your future endeavours.'

8. On or before 7 March 2004, the appellant received payment totalling \$450,438.21 from the former employer. The former employer particularised the items in a checklist as follows:

<u>'Final Pay Calculation:</u>		<i>HK\$</i>
Enhanced Salary	\$73390 (For the month of February 2004)	\$73,390.00
13th Month Bonus		
Outstanding Leave (9 days)	\$73390 x 9/29	\$22,776.21
Others: Back Payment on BMS	(\$73390 - \$50000) x 3 For Nov – Dec 2003 and Jan 2004	\$70,170.00
Others:		
	Relevant Income:	\$166,336.21
Employee MPF Contribution	For the month of February, 2004	(\$1,000.00)
Employee MPF VOL Contribution	(73390 x 5% - \$1000) For the month of February, 2004	(\$2,669.50)
Employee MPF VOL Contribution	(\$2669.5 - \$1500) x 3 For the period November 2003 - January 2004	(\$3,508.50)
	Sub-total:	\$159,158.21
Payment in lieu of Notice	1 month notice from 1 March, 2004	\$73,390.00
Severance Payment	\$22500 x 2/3 x 14.526 years	\$217,890.00
Final Pay Total:		<u>\$450,438.21</u>

Note: The excess of your retirement benefit balance over the amount of severance payment as set out above will be payable to you as soon as the redemption proceeds are ready.'

9. On 26 March 2004 the appellant filed a claim in the Labour Tribunal against the former employer for severance pay, long service payment and other claims totalling \$525,902.10. The appellant computed her claims for severance pay and long service payment on the basis of monthly wages of \$73,390.

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10. By order dated 23 April 2004, the Labour Tribunal ordered, by consent of the appellant and the former employer, that the former employer should pay to the appellant a sum of \$30,000 in full and final settlement of all the claims of the appellant.

11. In her 2003/04 individual tax return, the appellant claimed exemption in respect of, among others, the sum of \$93,560 as four months' back pay.

12. The appellant's claim was disallowed by the assessor and she objected.

13. The appellant's objection having failed before the Deputy Commissioner, the appellant appealed.

The appeal hearing

14. The appellant absented herself from the hearing of the appeal. She was represented by her husband as her representative.

15. The respondent was represented by Ms Poon So-chi, assessor.

16. Neither party called any witness.

17. The issue was whether the sum of \$93,560 which was the difference between \$73,390 (the monthly salary before the reduction which took effect from 1 November 2003) and \$50,000 (the monthly salary which took effect from 1 November 2003 as a result of the reduction) for the period from 1 November 2003 to 29 February 2004 (the last day of employment), that is, $(\$73,390 - \$50,000) \times 4 = \$93,560$, is liable to salaries tax.

The Board's Decision

18. Section 68(4) of the Inland Revenue Ordinance, Chapter 112, provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.

19. Section 8(1) provides that:

'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 ... any office or employment of profit ...'

20. Section 9(1)(a) provides that:

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'Income from any office or employment includes ... any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others ...'

21. In D60/97, IRBRD, vol 12, 367 at page 374, a decision of a panel chaired by Professor Andrew Halkyard, the Board quoted sections 8(1) and 9(1)(a) of the Ordinance and summarised the law succinctly as follows:

'On the basis of various authorities brought to our attention, including Hochstrasser v Maves (1959) 38 TC 673 per Viscount Simonds at 705, to be liable to salaries tax the Sum must arise from the employment, be referable to the services the Taxpayer rendered by virtue of his office and must be something in the nature of a reward for services past, present or future.'

22. The appellant's agreement on or about 16 October 2003 to accept a reduction in salary was not on the face of the letter dated 15 October 2003 supported by consideration. The appellant's husband asserted that if the appellant did not agree, she would be dismissed. We attach no weight to his bare assertion, not supported by any evidence. It is questionable whether the appellant's agreement to accept a lower salary was binding on her in law in view of her contractual entitlement to a higher salary, see generally paragraphs 3-065 – 3-075 and 3-115 – 3-116, volume 1, Chitty on Contracts, 29th edition.

23. If the agreement to accept a lower salary was in law not binding on the appellant, the appellant was entitled to be paid \$73,390 per month for the 4-month period from November 2003 to February 2004. \$93,560 was the shortfall. \$93,560 arose from the employment; was referable to the services the appellant rendered by virtue of her office; and was in the nature of a reward for services for the 4-month period. The sum was liable to salaries tax.

24. If the agreement to accept a lower salary was in law binding on the appellant, the appellant had no contractual entitlement to the sum. The sum was on top of her entitlement under the employer-employee legislation. To put it at its lowest, the appellant made no attempt to show that the sum formed part of her entitlement under the employer-employee legislation on termination of employment and the onus of proof was on her. The sum arose from the employment; was referable to the services over the years which the appellant rendered by virtue of her office; and was in the nature of a reward for her many years of past services. It was in the nature of a gift or gratuity which is expressly included as income under section 9(1)(a). The sum was liable to salaries tax.

Disposition

25. The appellant has failed to discharge her onus under section 68(4). We dismiss the appeal and confirm the assessment appealed against as reduced by the Deputy Commissioner.

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