

Case No. D65/06

Salaries tax – whether value of shares assessable income – what amount of value of the shares should be assessed – sections 8(1), 9(1), 11B and 68(4) of Inland Revenue Ordinance (‘IRO’).

Panel: Patrick Fung Pak Tung SC (chairman), Andrea Fong and Peter Ngai Kwok Hung.

Date of hearing: 17 October 2006.

Date of decision: 12 December 2006.

The taxpayer had since 2000 been employed by one Company A (‘the Employer’). By a letter dated 19 May 2004, the Employer informed the taxpayer that a new investment holding company, Company B, would be incorporated as part of its listing exercise on the Country E Stock Exchange. The Employer and most of its other subsidiaries would be restructured and held directly or indirectly by Company B. In recognition of his efforts and contribution to the Employer, the taxpayer was offered 169,170 shares (‘the Shares’) in Company B at a nominal consideration. One of the terms of the offer was that the taxpayer would not dispose of his share entitlement in Company B within a period of two years following the date of transfer. The taxpayer accepted the said offer by a Confirmation and Acceptance dated 19 May 2004. The consideration payable for the Shares was \$1.00 in Country E’s currency. The transfer of the Shares was duly caused to be made to the taxpayer. The Share certificate for the Shares dated 2 July 2004 was forwarded to the taxpayer on 23 July 2004. Endorsed on it were the following words: ‘THE SHARES COMPRISED HEREIN DO NOT CONSTITUTE GOOD DELIVERY UNTIL AFTER 15 JULY 2006’.

The Employer filed an Employer’s Return of Remuneration and Pensions for the year ended 31 March 2005 in respect of the taxpayer showing the particulars of income of the taxpayer including a sum of \$123,683 (‘the Sum’) being the value of the Shares. In his tax return – individuals for the year of assessment 2004/05, the taxpayer failed to declare the Sum as part of his income. The assessor raised on the taxpayer a salaries tax assessment for the year of assessment 2004/05 with tax payable in the sum of \$28,498 after taking into account the Sum as being part of the taxpayer’s income.

The taxpayer objected to the assessment on the grounds that the Sum, being the value of the Shares, should be excluded from the assessment. The taxpayer explained that the moratorium period imposed on the Shares did not allow him to sell them during the period from 23 July 2004 to 16 July 2006. Further, the price of the shares in Company B had dropped from around \$1.00 to

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

around \$0.225. Hence, the value of the shares should not be calculated according to the share price on the issue date and it should not be included in his salary for the year of assessment 2004/05.

The assessor maintained the view that the taxpayer should be assessed to tax in respect of the value of the Shares in the year of assessment 2004/05. She was, however, prepared to allow a discount of 10% on the Sum to reflect the 24-month moratorium period imposed of the Shares. The taxpayer did not agree with the assessor. The Deputy Commissioner had overruled the taxpayer's objection and upheld the assessor's revised assessment. The taxpayer appealed.

Held:

1. The shares allotted to the taxpayer for the nominal consideration of Country E's currency \$1.00 was a perquisite derived by the taxpayer from his office or employment with the employer within the meaning of section 9(1)(a) of the IRO. Hence, the sum, being the value of the shares, is assessable income for the purpose of salaries tax.
2. The fact that the taxpayer had been prevented from selling the shares during the moratorium period, the subsequent drop in the trading price of the shares in Company B and the indefinite suspension of trading of those shares on Country E Stock Exchange is a totally irrelevant consideration (D128/99, IRBRD, vol 15, 16 followed).
3. As to the value of the shares, the taxpayer had not adduced any evidence on valuation of the shares. Section 68(4) of the IRO puts the onus on an appellant taxpayer to prove 'that the assessment appealed against is excessive or incorrect'. The taxpayer had failed to discharge that burden in the present case. The Board had no alternative but to dismiss the taxpayer's appeal (D120/02, IRBRD, vol 18, 125 considered).

Appeal dismissed.

Cases referred to:

D128/99, IRBRD, vol 15, 16

D120/02, IRBRD, vol 18, 125

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

Taxpayer in person.

Chan Wai Yee and Wong Kai Cheong for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal by the Appellant ('the Taxpayer') against a determination by the Respondent ('the Commissioner') dated 30 June 2006 whereby the Commissioner by one of her deputies overruled an objection by the Taxpayer against a salaries tax assessment for the year of assessment 2004/05 but reduced the net chargeable income of \$196,492 with tax payable thereon of \$28,498 to a net chargeable income of \$184,124 with tax payable thereon of \$26,024.

2. The facts of the case are very simple and not in dispute. The Taxpayer has since 2000 been employed by one Company A ('the Employer'). By a letter dated 19 May 2004, the Employer informed the Taxpayer that a new investment holding company, Company B, would be incorporated as part of its listing exercise on the Country E Stock Exchange. The Employer and most of its other subsidiaries would be restructured and held directly or indirectly by Company B. In recognition of his efforts and contribution to the Employer, the Taxpayer was offered 169,170 shares ('the Shares') in Company B at a nominal consideration. The terms of the offer were as follows:

- (i) The Taxpayer would not dispose of his share entitlement in Company B within a period of two years following the date of transfer.
- (ii) His name would be registered in the register of members of Company B maintained in Country D. The share certificate would be kept by the company secretary of Company B during the two-year moratorium period.
- (iii) His dividend entitlement and voting right attached to the Shares would be identical to those of all other shares of Company B.

3. The Taxpayer accepted the said offer by a Confirmation and Acceptance dated 19 May 2004. The consideration payable for the Shares was \$1.00 in Country E's currency.

4. The transfer of the Shares was duly caused to be made to the Taxpayer. The Share Certificate for the Shares dated 2 July 2004 was forwarded to the Taxpayer on 23 July 2004. Endorsed on it were the following words:

'THE SHARES COMPRISED HEREIN DO NOT CONSTITUTE GOOD DELIVERY UNTIL AFTER 15 JULY 2006'.

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

5. The Employer filed an Employer's Return of Remuneration and Pensions for the year ended 31 March 2005 in respect of the Taxpayer showing, inter alia, the following particulars:

- (i) Capacity in which employed : Senior Sales Manager
- (ii) Period of employment : 1 April 2004 to 31 March 2005
- (iii) Particulars of income :

	\$	
Salary	184,809	
Bonus	30,000	
The Shares	<u>123,683</u>	(‘the Sum’)
Total	<u>338,492</u>	
	=====	

6. In his tax return – individuals for the year of assessment 2004/05, the Taxpayer failed to declare the Sum as part of his income.

7. The assessor raised on the Taxpayer a salaries tax assessment for the year of assessment 2004/05 with tax payable in the sum of \$28,498 after taking into account the Sum as being part of the Taxpayer's income.

8. By a letter dated 8 August 2005, the Taxpayer objected to the assessment on the grounds that the Sum, being the value of the Shares, should be excluded from the assessment. The Taxpayer explained that the moratorium period imposed on the Shares did not allow him to sell them during the period from 23 July 2004 to 16 July 2006. Further, the price of the shares in Company B had dropped from around \$1.00 to around \$0.225. Hence, the value of the Shares should not be calculated according to the share price on the issue date and it should not be included in his salary for the year of assessment 2004/05.

9. In response to the assessor's enquiry, the Employer provided the following information:

- (i) Company B was listed in Country E on 16 July 2004.
- (ii) The value of the Shares, that is, the Sum, was calculated as follows:

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

Number of shares held X Closing price of the first trading date on 16 July 2004
X Exchange rate (for Country E's currency)
= 169,170 X S\$0.16 X HK\$4.5695
= HK\$123,683.57

- (iii) The Taxpayer undertook not to transfer, assign or dispose of any part of his shareholdings in Company B for a period of 24 months from the date of listing.
- (iv) The Shares awarded would not be withdrawn and the moratorium would not be amended in case of termination of the employment of the Taxpayer.

10. The assessor maintained the view that the Taxpayer should be assessed to tax in respect of the value of the Shares in the year of assessment 2004/05. She was, however, prepared to allow a discount of 10% on the Sum to reflect the 24-month moratorium period imposed on the Shares. Accordingly, the assessor proposed to the Taxpayer that the salaries tax assessment for the year of assessment 2004/05 be revised as follows:

		\$
Income		338,492
<u>Less</u> : 10% discount on the Sum		12,368
		<hr/>
		326,124
<u>Less</u> : Retirement scheme contribution		12,000
		<hr/>
		314,124
<u>Less</u> : Basic allowance	100,000	
Dependent parent allowance	30,000	130,000
	<hr/>	
Net chargeable income		184,124
		<hr/>
Tax payable thereon		26,024
		<hr/>

11. The Taxpayer did not agree with the assessor. The Deputy Commissioner has overruled the Taxpayer's objection and upheld the assessor's revised assessment. Hence, this appeal.

The issues

12. There are only two issues in this appeal:
- (i) Whether the value of the Shares was assessable to salaries tax for the year of assessment 2004/05.
 - (ii) If it was, at what amount the value of the Shares should be assessed to tax.

The relevant law

13. Section 8(1) of the Inland Revenue Ordinance Chapter 112 ('IRO') provides as follows:

'8. Charge of salaries tax

(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.'

14. The relevant parts of section 9 of the IRO provide as follows:

'9. Definition of income from employment

(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, except –

...

(iv) subject to subsection (2A), any amount paid by the employer to or for the credit of a person other than the employee in discharge of a sole and primary liability of the employer to that other person, not being a liability for which any person was surety;

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

...

- (d) *any gain realized by the exercise of, or by the assignment or release of, a right to acquire shares or stock in a corporation obtained by a person as the holder of an office in or an employee of that or any other corporation.*

...

- (2A) *Subsection (1)(a)(iv) shall not operate to exclude –*

- (a) *any benefit that is –*

- (i) *provided by an employer otherwise than in connection with a holiday journey; and*
- (ii) *capable of being converted into money by the recipient;*

...

- (4) *For the purposes of subsection (1) –*

- (a) *the gain realized by the exercise at any time of such a right as is referred to in paragraph (d) of that subsection shall be taken to be the difference between the amount which a person might reasonably expect to obtain from a sale in the open market at that time of the shares or stock acquired and the amount or value of the consideration given whether for them or for the grant of the right or for both; ...*

- (5) *Where salaries tax may by virtue of subsection (1)(d) become chargeable in respect of any gain which may be realized by the exercise of a right, salaries tax shall not be chargeable under any other provision of this Ordinance in respect of the receipt of the right.'*

15. Section 11B of the IRO provides as follows:

'11B. Ascertainment of assessable income

The assessable income of a person in any year of assessment shall be the aggregate amount of income accruing to him from all sources in that year of assessment.'

16. Section 68(4) of the IRO provides as follows:

'68. Hearing and disposal of appeals to the Board of Review

...

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

17. In Case No D128/99, IRBRD, vol 15, 16, the taxpayer, by reason of his employment with a number of companies, was entitled to various options in respect of shares of those companies. He exercised his right to subscribe for shares in those companies on various dates. The taxpayer argued that his tax liability should be confined to his actual gain because as a director of those companies, he was prevented by the Listing Rules from selling the shares in August 1997 when the shares were quoted at high levels in the Hong Kong Stock Exchange. It was decided by this Board (differently constituted) that all the cases before the Board were unanimous in concluding that section 9(4)(a) of the IRO sought to tax a notional gain assessed in the way defined by that subsection. It was not referring to actual gain. The actual gain could be much more or much less or it could even be a loss. As the assessment was based on a notional gain, the fact that the taxpayer did not in fact realize such gain because of circumstances beyond his control was not relevant. There was no equity in a taxing statute.

Our decision

18. We are in no doubt that the Shares allotted to the Taxpayer for the nominal consideration of Country E's currency \$1.00 was a perquisite derived by the Taxpayer from his office or employment with the Employer within the meaning of section 9(1)(a) of the IRO. Hence, the Sum, being the value of the Shares, is assessable income for the purpose of salaries tax.

19. We find on the established principles that the fact that the Taxpayer has been prevented from selling the Shares during the moratorium period, the subsequent drop in the trading price of the shares in Company B and the indefinite suspension of trading of those shares on Country E Stock Exchange is a totally irrelevant consideration.

20. We had some doubt relating only to the value of the Shares assessed by the Inland Revenue Department and the discount of 10% given.

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

21. On the value of the Shares, the Commissioner relies on the said Employer's Return filed by the Employer and says that the Employer should know best about the value of the Company B shares.

22. On the discount of 10%, the Commissioner's representative has informed the Board that there are no previous cases with identical facts. She relies on the previous decision of the Board in Case No D120/02, IRBRD, vol 18, 125 in which a discount of 25% was given by the Inland Revenue Department in relation to certain shares which the employee subscribed for and which could not be sold for five years. That decision appears to have been based at least partly on evidence before the Board indicating that the United Kingdom Capital Taxes Office was prepared to allow a 25% discount to 'reflect the five year restriction period with early release clauses'.

23. We note that in the last-mentioned case the facts are not identical to those in the case before us. We also wonder whether it can be said that a rule of thumb has been established to the effect that a discount of 5% should be given for every year in which shares cannot be sold.

24. The Taxpayer, however, has not adduced any evidence on valuation of the Shares. Section 68(4) of the IRO puts the onus on an appellant taxpayer to prove 'that the assessment appealed against is excessive or incorrect'. The Taxpayer has failed to discharge that burden in the present case.

25. Accordingly, we have no alternative but to dismiss the Taxpayer's appeal.

26. We should add that we have great sympathy for the Taxpayer. Since he is still employed by the Employer who obviously intended to reward him for his good performance rather than to cause him to assume an unwanted burden which has arisen out of circumstances beyond his control, we can only hope that his Employer will see some way of relieving him of such unwanted burden. This observation of ours of course has nothing to do with our decision in this appeal.