

**Case No. D66/06**

**Salaries tax** – gain realized by exercise of share option – date of assessment – sections 9(1)(d) and 9(4) of the Inland Revenue Ordinance ('IRO')

Panel: Jat Sew Tong SC (chairman), Clement Chan Kam Wing and Gordon Kwong Che Keung.

Date of hearing: 18 October 2006.

Date of decision: 12 December 2006.

The appellant was an employee of S Ltd. By reason of her employment, she was entitled to participate in a share option scheme of D Ltd, an associated company of S Ltd.

On 25 October and 19 November 2004, the appellant exercised her option and applied to subscribe for some shares of D Ltd. On or about 24 November 2004, D Ltd's board resolved to allot the shares to her. On 25 November 2004, share certificates for the shares were issued to the appellant. However, the appellant was not notified of the issue of the share certificates to her until 7 December 2004. On 30 November 2004, trading in D Ltd's shares was suspended. The suspension continued until 11 January 2006, by which time the price of D Ltd's shares had fallen significantly.

The Commissioner contended that the relevant date for determining the gain realized by the appellant as provided under sections 9(1)(d) and 9(4) of the IRO was 25 November 2004 when the share certificates were issued to her.

The appellant asserted that as a matter of fact she never made any gain from her exercise of the option because she could not have sold her shares on the open market before she had received the share certificates, and by the time she received the share certificates trading had already been suspended.

**Held:**

1. Sections 9(1)(d) and 9(4) envisage a notional gain rather than an actual gain. Indeed, the statute does not require that there should be an actual sale, but only a notional sale on the relevant date.

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2. The relevant date for determination of the notional gain is the date when the shares were acquired by the appellant. As a matter of law, shares are acquired when they are allotted to the shareholder. At the latest, that would be when the share certificates (which are not documents of title but only documents evidencing the holder's title) were issued to the shareholder. On the facts of this case, that date was 25 November 2004 (D43/99; D128/99; D120/02; D84/03 followed).
3. On that day, the appellant could have notionally sold the shares on the open market. The fact that she was unable to do so because she had not received the share certificates is irrelevant (D43/99 considered).

**Appeal dismissed.**

Cases referred to:

D43/99, IRBRD, vol 14, 448  
D128/99, IRBRD, vol 15, 16  
D120/02, IRBRD, vol 18, 25  
D84/03, IRBRD, vol 18, 832

Taxpayer in person.

Wong Ki Fong and Lau Yuen Yee for the Commissioner of Inland Revenue.

**Decision:**

**Introduction**

1. This is an appeal against a determination dated 30 June 2006, by which the Commissioner determined that, for the assessment year 2004/05, the Appellant's taxable income from her employment included a sum of \$37,496.
2. The Commissioner determined that the sum of \$37,496 was a gain realized by the exercise of a right to acquire shares obtained by the Appellant by reason of her employment, hence falling within sections 9(1)(d) and 9(4) of the Inland Revenue Ordinance ('IRO'). The Appellant claims that she never in fact made any gain.

**The facts**

3. The relevant facts, which are not in dispute, are as follows.

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4. The Appellant joined S Ltd in February 1993. S Ltd was an associated company of a listed company, which we shall call D Ltd.

5. By reason of her employment with S Ltd, the Appellant was eligible to participate in D Ltd's Share Option Scheme.

6. Pursuant to that Share Option Scheme, on 25 October and 19 November 2004 the Appellant exercised an option given to her and applied to subscribe for a total of 48,000 shares of D Ltd at \$1.66 per share (totally \$79,680).

7. On or about 24 November 2004, D Ltd's board approved the Appellant's application and resolved to allot 48,000 shares to her. On 25 November 2004, two share certificates each for 24,000 shares were issued to the Appellant.

8. However, the Appellant was not notified of the approval of her application and the issue of the share certificates to her until 7 December 2004. That was unfortunate because on 30 November 2004, trading in D Ltd's shares was suspended. The suspension continued until 11 January 2006, by which time the price of D Ltd's shares fell to around \$1.1. The price of D Ltd's shares never rose above \$1.66 since trading resumed.

9. The closing prices of D Ltd's shares on the following dates were:

25 October 2004:	2.40
19 November 2004:	2.63
25 November 2004:	2.50

10. Further, for the purpose of this appeal, the Commissioner's representative accepted that in practical terms the Appellant would not be able to dispose of the 48,000 shares until she has received the share certificates.

**Commissioner's determination**

11. The Commissioner considered that, pursuant to sections 9(1)(d) and 9(4) of the IRO, there was a gain realized by the Appellant upon her exercise of the share option which was chargeable for income tax.

12. The Commissioner considered that the relevant date for determining the gain realized by the Appellant as provided under the statute was the date when the shares were acquired by the Appellant, not when the shares certificates were received by her. That date was 25 November 2004 when the share certificates were issued to her, at which time the Appellant acquired title to those shares. The Commissioner relied on a number of previous decisions of this Board, including

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D43/99, IRBRD, vol 14, 448, D128/99, IRBRD, vol 15, 16, D120/02, IRBRD, vol 18, 125, and D84/03, IRBRD, vol 18, 832.

13. However, the Commissioner was prepared, on an ex gratia basis, to adopt the closing price on 25 October 2004 in relation to 24,000 of the 48,000 shares. The Commissioner was also prepared to allow a deduction for notional expenses which would reasonably have been incurred in a sale of the Appellant's shares in the open market.

14. The net chargeable amount taking into account the aforesaid deductions was \$37,496.

**The Appellant's contention**

15. The Appellant understandably did not address the Board on the interpretation of the relevant statutory provisions or the decisions relied on by the Commissioner. Her main submission was that as a matter of fact she never made any gain from her exercise of the option because she could not have sold her shares on the open market before she had received the share certificates, and by the time she received the share certificates trading had already been suspended.

**The relevant statutory provisions and their proper construction**

16. Section 9(1)(d) and 9(4) are in the following terms:

*'(1) Income from any office or employment includes-*

*...*

*(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 ...*

*(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 ...'*

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17. As pointed out in decisions of the Board cited to us (D43/99, D128/99, D120/02, D84/03), with which this Board agrees, the statute envisaged a notional gain rather than an actual gain. Indeed, the statute does not require that there should be an actual sale, but only a notional sale on the relevant date.

18. This Board also agrees with the previous decisions of the Board referred to above that the relevant date for determination of the notional gain is the date when the shares were acquired by the taxpayer. As a matter of law, shares are acquired when they are allotted to the shareholder. At the latest, that would be when the share certificates (which are not documents of title but only documents evidencing the holder's title) were issued to the shareholder.

19. On the facts of this case, that date was 25 November 2004.

### **Decision**

20. For the reasons given above, this Board is unable to accept the Appellant's contention that there was no gain realized within the meaning of section 9(1)(d). The Commissioner was clearly right to determine that the Appellant acquired the 48,000 shares on 25 November 2004. On that day, the Appellant could have notionally sold the shares on the open market. The fact that she was unable to do so because she had not received the share certificates is irrelevant.

21. For completeness, this Board should mention that in decision D43/99, the Board, having determined (in paragraph 29 of the decision) that the material time was the time when the shares were acquired, went on to consider (in paragraph 30) that the taxpayer could have sold the shares on the date when the share certificates were issued to him and available for collection (6 July 1993). The Board rejected the taxpayer's contention that he could not have sold the shares until he received the certificates (9 July 1993). It might therefore be argued that the Board considered that the date of acquisition was the date when the share certificates were available for collection by the taxpayer. However, in that case the two dates in issue were the date when the shares were available for collection and the date when they were actually received by the taxpayer. Neither side contended that the date of acquisition was when the shares were allotted to the taxpayer (on the facts of that case, that date was 25 June 1993: see paragraph 9 of the decision). Hence, one cannot rely on that decision as authority for the proposition that the relevant date was the date when the share certificates became available to the taxpayer.

22. Finally, we would like to express our considerable sympathy to the Appellant. She may rightly feel that the statute has worked an injustice on the rather unusual circumstances of her case. However, we think the law is clear and we regret that her appeal must be dismissed.