Case No. D6/90

Salaries tax – education expenses – whether taxable.

Panel: Robert Wei QC (chairman), Philip Fu Yuen Ko and Kenneth Kwok Hing Wai.

Dates of hearing: 20 and 29 September 1988.
Date of decision: 20 April 1990.

The employer of the taxpayer undertook to pay the school fees of his children. Subsequently the employer decided not to pay the school fees but the taxpayer did not accept this decision made by his employer. A dispute arose between the taxpayer and his employer with regard to who was liable to pay the school fees. The taxpayer submitted that he was not responsible for payment of the school fees which was the responsibility of his employer. He submitted that the school fees were not part of his taxable emoluments.

Held:

On the evidence before the Board, it appeared that the employer should pay the school fees. The school fees were part of the taxable emoluments of the taxpayer. Glynn v CIR applied.

Appeal dismissed.

[Editor's note: This case was heard on 20 and 29 September 1988 at which time the Glynn v CIR case was pending before the courts. The decision in this case was deferred pending the ultimate outcome of the Glynn case which was determined by the Privy Council on 22 January 1990.]

Case referred to:

Glynn v CIR Privy Council Appeal No 23 of [1989]

J G A Grady for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal by a taxpayer against the salaries tax assessments for the years of assessment 1982/83, 1983/84 and 1984/85 raised on him and confirmed by the Deputy Commissioner of Inland Revenue. He claims that the sums paid by X Limited ('X Ltd'), his employer, in respect of education expenses of his children are not chargeable to salaries tax.

2. The Taxpayer appeared in person. He called no witnesses, nor did he take the witness stand. However, as he had no objection to being asked questions by Mr Grady who was appearing for the Revenue, it was ruled by the Board, with the consent of both parties, that the statements of fact made by the Taxpayer in the course of his submission be treated as his evidence-in-chief and that his answers to questions put by Mr Grady be treated as his evidence in cross-examination, and the hearing proceeded on that basis.

3. The primary facts, so far as they are material to this decision, are as follows:

3.1 The Taxpayer was appointed managing director of X Ltd on 1 July 1979.

3.2 The appointment was on terms, inter alia, that the employer undertook to pay the school fees of his children, whether in Hong Kong or overseas.

3.3 At all material times the two children went to school in Singapore.

3.4 At all material times the employer paid the school fees direct to the school on bills addressed to the employer and bearing, for the first two years or so, the notation 'For the account of [the Taxpayer]', which was changed to 'Attn: [the Taxpayer]' in 1981 or 1982 at the Taxpayer's request. The last payment was made on 5 September 1984.

3.5 On 6 September 1984 the chairman of the board of the employer wrote to the Taxpayer as follows:

> ' Further to our discussion repayment of your children's school fees.
>
> It has been decided by consultation with our other directors that school fees should properly be a part of your personal liability and as such should not be paid by the company. Hence, effective from January 1983 school fees will be paid by you. Fees already paid by the company will be considered a loan and debited to your personal account.
>
> We have noted your objections to this course of action but feel any problems will be overcome by a generous dividend we anticipate for the coming trading year and years to come.'

3.6 On 1 October 1984 the headmaster of the school wrote to the chief assessor (appeals) of the Inland Revenue Department as follows:

> ' I write in response to your letter, reference IRA/2/990, of 21 September 1984 in the above connection.
>
> We have checked our records with a view to answering each of your questions as precisely and factually as possible. Accordingly, we would advise as follows:
>
> 1) [Miss A] [Taxpayer's daughter] was placed in the college in September 1978 by her local guardian, a [Mr B], whilst the natural mother of [Mr C] [Taxpayer's son], a [Mrs D], placed him in school in September 1981.
>
> 2) We regard the completed application form and the signed acceptance letter as the formal contract between parents and the college. Copies of both sets of documents relating to [Miss A's] enrolment in 1978 and [Mr C's] enrolment in 1981 are attached as appendices (I) and (II).
>
> 3) We have since September 1978 invoiced [the Taxpayer], a resident of Hong Kong, who is the natural father of the two children for their termly fees. This was done on the instructions of the two children's mother, [Mrs D], who gave us to understand that the terms of her separation with [the Taxpayer] guaranteed that he would be responsible for their educational costs.
>
> 4) We invoiced [X Ltd] instead of [the Taxpayer] for the termly fees of his children at his request.
>
> 5) The notation "for account of [the Taxpayer]" in the termly bills for fees was included to draw attention to the fact that we (the college) regarded [the Taxpayer] as being personally responsible for the payment of these dues and not the company.
>
> 6) We would look to [the Taxpayer] for legal redress in the event of default in the payment of school fees for his children. Admittedly, from a legal viewpoint, we might encounter some difficulties in establishing "liability" since the original contracts were entered into with a third party.
>
> I trust the foregoing clarifies the position to your satisfaction.'

3.7 On 14 December 1984 the Taxpayer, as managing director, wrote on behalf of the employer to the Commissioner of Inland Revenue, describing the school fees for the period from 1 April 1982 to 31 March 1984 as 'amount of children education expenses paid in accordance with our [that is, the employer's] obligation for children education'.

3.8 The employer made an accumulated loss of over $4,000,000 at the end of 1984. In January or February 1985 it ceased business due to liquidity problems.

3.9 On 12 March 1985 the Taxpayer wrote to the Inland Revenue Department enclosing a copy of the letter of 6 September 1984 from the chairman to the Taxpayer (referred to in paragraph 3.5 above) and stating,

> ' You will see from these that my children's school fees from January 1983, are my own personal liability and should not be included as taxable income.'

3.10 On 1 April 1985 the Taxpayer resigned as managing director of the employer.

3.11 On 10 April 1985 the Taxpayer wrote to the employer for the attention of the chairman as follows:

> ' I refer to my letter of resignation dated 1 April 1985 and wish to point out the company owes me an amount of $223,164.31 which has been outstanding for well over twelve months.
>
> While I have no wish to make things difficult I would like to know when I might reasonably [sic] expect to have this matter cleared.'

3.12 On 7 May 1985 the chairman replied as follows:

> ' Thank you for your letter of 10 April 1985 regarding outstandings to you amounting to $223,164.31. In reply I can only say we will meet our obligations as soon as possible.
>
> However, I would like to resolve one matter and that is in relation to the payments made by the company for your children's school fees. This has been a matter of some lengthy discussion between us in the past and I realize we have not always seen eye to eye on this matter. It was however agreed in September 1984 that school fees would be for your account, however, when writing my letter of 6 September 1984 to you the date January 1983 was inserted instead of the duration of your employment. Hence, the figure should be as follows:

		$
School fee paid:	1981	16,127.39
	1982	57,845.70
	1983	64,202.80
	1984	75,309.96
	Total	$213,485.85
		=========
Amount owed you		$223,164.31
Less: School fee paid		213,485.85
Current owed		$9,678.46
		=======

I have instructed the accounts to make the necessary adjustments in our books and will endeavour to meet the balance of an obligation within the next two months.

I hope you understood the situation.'

3.13 On 22 May 1985 the Taxpayer replied as follows:

'I cannot believe you can possible [sic] mean what you said in your letter of 7 May 1985. I know we have had disagreements in the past but this is extraordinary.

Although I did not agree with my being responsible for the payment of my children's school fees. [sic] I reluctantly agreed to have this change from January 1983, certainly not further back.

Unless your decision is reversed you leave me no alternative but to seek legal action to recover what is rightfully mine. I expect a reply to this letter within seven days.'

3.14 On 3 June 1985 the employer wrote to the Inland Revenue Department as follows:

'I refer to your letter of 19 April, your ref 2C5-XD0086974, I confirm the figures mentioned in our letter of 14 December as stated in your letter as having been paid for education expenses and debited against [the Taxpayer's personal account.

> The reason why there is a confusion over our letter of 14 December is basically due to a reply being made by a member of our staff who was simply confirming education fees had been paid. The fact of an adjustment to the condition of this payment was not asked for in your enquiry and it was presumed that a change in obligation made no difference in tax liability.
>
> The circumstances leading to the withdrawal of this benefit were as a result of a discussion between the chairman and shareholders of the company, who felt that the liability of children education should be borne by [the Taxpayer]. You have a copy of the chairman's letter expressing those sentiments on your file.
>
> …'

3.15 On 6 September 1986 the Taxpayer provided the assessor with a copy of the employer's director's allowance account for the year ended 31 December 1984 showing that the entries relating to school fees totalling $75,309.96 paid by the employer during that year were reversed on 31 December 1984.

3.16 On 13 May 1986, during an interview with two officers of the Inland Revenue Department the Taxpayer asserted that the payment of school fees was a matter of contract between the employer and the school.

3.17 On 27 May 1986 the Taxpayer wrote to the assessor enclosing a copy of a certificate date 14 May 1985, signed by the headmaster of the school, which reads as follows:

> TO WHOM IT MAY CONCERN
>
> This is to certify that tuition fees in respect of [Miss A] and [Mr C] [the two children] have for the past six years been charged to [X Ltd, GPO Box Y, Hong Kong].'

In the letter the Taxpayer stated:

> 'I submit this in support of my statement that all school fees for my children were the direct responsibility of my then employer, [X Ltd], contracted for by [X Ltd] and hence do not constitute taxable income.'

3.18 On 3 September 1987 the Deputy Commissioner of Inland Revenue rendered his determination.

3.19 On 3 October 1987 the Taxpayer filed his notice of appeal and grounds of appeal which read as follows:

‘ GROUNDS OF APPEAL

1. I agreed with the company (my employer) that the school fees for my children from 1 January 1983 onwards should be borne by my own self, even though the company has signed contract with me which said the company should pay my children’s school fee.

2. The financial statements of the company (my employer) for the year ended 31 December 1984 submitted to the Inland Revenue Department on 6 September 1985 showed that the company did not pay the school fee for my children. There was no such expenses item in its profit and loss account, which was related to my children’s school fee.

3. For the year ended 31 December 1985, the company made the adjustment entry to reverse back the school fees of my children to my current account. That means I should bear the said school fee (as agreed to reason 1) and the company just paid on my behalf.

4. [Here the Taxpayer cited section 11D(a) of the Inland Revenue Ordinance.]

In this case, I have compromised with the company that I was not paid my children’s school fee only from 1 January 1983 onwards. My assessable income should be what I actually benefit from the company, but not what I contract with the company.’

3.20 At the adjourned hearing of this appeal on 29 September 1988, the Taxpayer produced a letter dated 22 September 1988 addressed by the headmaster of the school to the chief assessor (appeals) of the Inland Revenue Department which reads as follows:

‘I understand my letter to you of 1 October 1984 regarding [the Taxpayer] and his obligation for payment of school fees for his children, [Miss A] and [Mr C], has been misinterpreted.

Let me clarify the position.

We have always understood that the primary entity responsible for the payment of school fees, during the entire time during which [Mr C] and [Miss A] attend (sic) (the school) was [X Ltd]. Accounts, invoices were sent for payment to [X Ltd] and all payments were received directly from [X Ltd].

> As [the Taxpayer] is the natural parent of [Miss A] and [Mr C], however, we believed that in the event of a default in payment by [X Ltd], then [the Taxpayer] would have a moral responsibility for the payment, to ensure his children's continued education.
>
> I sincerely hope this clears any misunderstanding.'

4. At the hearing of this appeal, and with the permission of the Board, the Taxpayer reintroduced as a ground of appeal a point which he had mentioned to the Inland Revenue Department on some occasions but which was not included in his grounds of appeal filed on 3 October 1987, namely, that ever since 1 July 1979 when he was appointed managing director, it was the sole liability of the employer to pay the school fees, and there was no personal liability on his part to pay any such fees, and further that the employer not only owed a contractual obligation to him to pay the school fees, but also owed a contractual obligation to the school to pay them. He maintained emphatically throughout the hearing of this appeal that he never accepted liability for the school fees as suggested in the chairman's letter dated 6 September 1984 (see paragraph 3.5 above) and that he told the chairman so. He stated that following upon the letter of 6 September 1984, there were discussions and negotiations between the chairman and himself, and he quoted the following conversation as an example:

> ' I said, "Look, I stick by my terms of employment." And he said, "Why don't you just let it go for the time being, adjust the accounts accordingly so that we can present good books to the bank and then I will inject a million dollars with the capital and I will refund you all this money." And I said, "Okay, I will do, I will make the adjustments in the books but I don't accept liability for school fees."'

He agreed to an adjustment of the accounts as requested by the chairman as from January 1983, and he would be compensated by means of a bonus or an issue of stock for the accommodation. But there was no question of accepting any personal liability for the school fees, and this was important because he was thinking of the day when the relevant entries in the books would once again be reversed thereby restoring the benefit of the school fees, and this could only be achieved on the basis that payment of the school fees was the employer's liability. But the promised million dollar injection of funds did not materialize, and liquidity problems forced the employer to cease business in January or February 1985. On 1 April 1985 the Taxpayer resigned as managing director. On 10 April 1985 he wrote to the chairman (see paragraph 3.11 above) asking for an indication as to when he might reasonably expect a settlement of the sum of $223,164.31 owed to him by the employer. That letter was written on the basis that there was no personal liability on his part to pay school fees because the sum in question was the full amount of the debt without giving any credit for any of the school fees. On 7 May 1985 the chairman replied (see paragraph 3.12 above) to the effect that it was agreed in September 1984 that school fees should be paid by the Taxpayer and that the Taxpayer's liability should take effect for the duration of the employment and not just from January 1983. On 22 May 1985 the Taxpayer replied as

shown in paragraph 3.13 above. Before us his explanation of the second paragraph of the letter was that the expression 'this change' referred to the change in the accounts and that the whole paragraph meant that he did not accept any liability for the school fees and that he only reluctantly agreed to an adjustment of the accounts as from January 1983. The expression 'what is rightfully mine' in the third paragraph referred to the full amount of $223,164.31.

5. We accept the Taxpayer's evidence summarised in paragraph 4 above. The difference between the employer's proposal embodied in the letter of 6 September 1984 and the Taxpayer's counter proposal is that there was nothing for the Taxpayer to gain on the employer's terms while there would or might be some gain for him on his terms. However, the letters exchanged between the chairman and the Taxpayer as referred to in paragraph 4 above reveal a conflict of evidence as to what was agreed between them. They certainly agreed that the debt owed by the employer to the Taxpayer should be reduced by amounts equal to the school fees paid by the employer as from January 1983, but they were at loggerheads as to whether the reduction was based on an agreement that the Taxpayer should assume liability for the school fees retrospectively. On the evidence we are unable to find that they reached any agreement on the question of liability for the school fees. It follows therefore that they continue to be governed by the contract of employment which provides that the employer should pay the school fees. In reaching this conclusion we took into consideration the fact that the Taxpayer had been taking contradictory stands on this question in dealing with the Inland Revenue Department. On some occasions he represented that the payment of the school fees was his personal liability (see paragraphs 3.9, 3.14 and 3.19 above), the last such representation being his grounds of appeal filed on 3 October 1987, while on other occasions he asserted that the payment of the school fees was a matter of contract between the employer and the school (see paragraphs 3.7, 3.16, 3.17 and 4 above), the last instance being the hearing of this appeal, during which for obvious reasons the grounds of appeal as filed were not pursued by the Taxpayer, though not expressly withdrawn. In our view, these inconsistencies were due to the Taxpayer's desire to introduce the 'personal liability' argument as an additional or alternative ground for saying that the school fees do not constitute taxable income. This was an exercise in futility, because, for lack of a valid factual basis, the argument was not available to him after all at the hearing of the appeal.

6. On 22 January 1990 the Privy Council delivered its judgment in Glynn v CIR, privy Council Appeal No 23 of [1989]. Lord Templeman says at page 6:

> ' For present purposes it suffices that an identifiable sum of money required to be expended by an employer, pursuant to a contract of service for the benefit of the employee, is money paid at the request of the employee and is either part of the employee's salary or is a monetary perquisite taxable as such according to the law and authorities of the United Kingdom.
>
> Salaries and perquisites, expressions which have formed part of the United Kingdom income tax law since at least 1842, must have the same meaning in

> Hong Kong tax law, which is based on United Kingdom law, provided that the Hong Kong legislation does not attach different meanings to those expressions.'

So the question to ask in the present case is whether the school fees are sums of money required to be expended by the employer, X Ltd, pursuant to a contract of service for the benefit of the Taxpayer, the employee. The answer must be yes. The school fees are therefore taxable as perquisites. It is irrelevant to ask whether there was a contract between the employer and the school which imposed an obligation on the employer to pay the school fees to the school.

7. Mr Grady for the Revenue submitted that even assuming that the Taxpayer agreed to assume liability for the school fees retrospectively, the school fees would still have formed part of his assessable income which had accrued to him before the agreement and would still have been taxable. One can see the logic of the argument even though he did not cite any authorities. However, as we take the view that the Taxpayer did not agree to assume any such liability, the point does not arise.

8. This appeal is therefore dismissed and the assessments in question are hereby confirmed.