

INLAND REVENUE BOARD OF REVIEW DECISIONS

**Case No. D70/01**

**Salaries tax** – income – lump sum received from employer on cessation of employment – sections 8(1), 9(1)(a), 11D and 68(4) of the Inland Revenue Ordinance (‘IRO’) – rental allowances – sections 8(1), 9(1)(b), 9(1)(c), 9(1A), 9(2), 61 and 68(4) of the IRO.

Panel: Anna Chow Suk Han (chairman), Emily Lam Yuet Ming and Alexander Woo Chung Ho.

Date of hearing: 13 March 2001.

Date of decision: 28 August 2001.

By a termination agreement dated 3 July 1995, the taxpayer and Company C agreed to certain terms governing the termination of the taxpayer’s employment with Company C on 30 June 1995. The taxpayer then commenced his employment with Company E on 1 July 1995.

The terms of the termination agreement included, among others, that the taxpayer should be paid a lump sum of \$2,310,000 ‘as full and final settlement of all claims (present or future) for all remuneration (accrued or unaccrued, statutory or otherwise) in relation to the service agreement’. In its notification dated 5 July 1995, Company C stated the lump sum as ‘payment in lieu of all compensation’. In his tax return for the year of assessment 1995/96, the taxpayer declared that part of the lump sum (\$1,310,000) (‘the Sum’) was ‘payment in lieu of notice and compensation for loss’ and the Sum was not offered for assessment.

In the said notification, Company C disclosed under the heading ‘Quarters provided’ that \$159,000 was paid as rent by Company C to the landlord of the taxpayer. The employer’s return of Company E showed under the heading ‘Quarters provided’ that \$477,000 was paid through the taxpayer to his landlord.

The assessor was of the view that the whole of the lump sum and the alleged rents paid by Company C and Company E respectively should be charged to salaries tax.

Company C provided the following information to the Revenue:

1. The taxpayer resigned voluntarily.
2. The lump sum was not made in accordance with the provisions of the Employment Ordinance. Instead, it was a negotiated amount of compensation. The Sum was treated as payment in lieu of notice and compensation for loss of office.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

3. There was no control exercised by Company C to ensure that the rent refund was actually expended by the taxpayer in the payment of rent.

The service agreement between Company E and the taxpayer provided that the taxpayer would receive a salary (inclusive of a housing allowance in such amount as Company E and the taxpayer might from time to time agree) at the rate of \$120,000 per month and a 13<sup>th</sup> month payment of \$120,000 at the end of the Chinese lunar calendar year.

The taxpayer attended the hearing and chose to give sworn testimony. He told the Board that two groups of major shareholders in Company C had a dispute. After that his relationship with some of the senior officials deteriorated to the extent that they finally came to an agreement that he should leave. It was a gentleman's agreement that he would leave when he was able to find a position which would accommodate him as a council member of the Stock Exchange of Hong Kong. The terms of the termination agreement were negotiated on his behalf by a colleague senior to him. It was understood between the parties that the termination payment should include a bonus and also compensation for loss of office.

The taxpayer also told the Board that his remuneration from Company C included a housing allowance although it was not stated in the contract. He explained that he had the same arrangement with Company E on the housing benefits.

With regard to the Sum, the issue before the Board was whether the taxpayer resigned voluntarily and the Sum was a payment by Company C on account of the taxpayer's past services or the taxpayer resigned involuntarily and it was a payment as compensation to the taxpayer for loss of employment.

With regard to the two sums of rental allowance, the question was whether they were housing allowances or whether they were sums forming part of the income of the taxpayer.

### **Held:**

1. The Board accepted the taxpayer's evidence that there had been disharmony between the senior management and the taxpayer. As a result they had come to an agreement that the taxpayer should leave as soon as he found a new job. In the commercial world, more often than not when an employee, especially if he holds a senior position in a company, is asked to leave the company by his employer, for various reasons, whether maintaining a harmonious relationship between the parties or preserving their images to outside parties or other reasons, the employee is often said to have resigned of his own accord. Moreover, Company C confirmed that the Sum was a negotiated amount and it represented a payment in lieu of notice and

## INLAND REVENUE BOARD OF REVIEW DECISIONS

compensation for loss of office. Had there been a voluntary resignation on the part of the taxpayer, negotiation and an apportionment would not arise. As to the Respondent's contention that in the termination agreement the lump sum was said to be in settlement of all remuneration under the service agreement, the Board thought that it stood to reason that Company C should so describe the said payment. Since it was agreed between the parties that the taxpayer was to resign of his own accord, surely the amount agreed to be paid by Company C could not have been put in the termination agreement as compensation for loss of office.

2. A 'refund' of rent connotes a repayment or reimbursement, not mere payment. This means, in a typical case, that sufficient control must, as a matter of fact (not just in theory), be exercised by the employer over the payment so that the allowance is effectively a refund of rent and not just an additional emolument to be spent in any way that the employee may desire. Based on the documentary and oral evidence, the Board found that the taxpayer had failed to discharge the burden on him to prove that the sums of \$150,000 and \$477,000 were indeed housing allowances.

### **Appeal allowed in part.**

Cases referred to :

D24/97, IRBRD, vol 12, 195  
Henley v Murray 31 TC 351  
D19/92, IRBRD, vol 7, 156  
D33/97, IRBRD, vol 12, 228  
D18/99, IRBRD, vol 14, 204  
D77/99, IRBRD, vol 14, 528  
D94/99, IRBRD, vol 14, 603  
D3/97, IRBRD, vol 12, 115  
D92/95, IRBRD, vol 11, 173  
D19/95, IRBRD, vol 10, 157

## INLAND REVENUE BOARD OF REVIEW DECISIONS

Chow Cheong Po for the Commissioner of Inland Revenue.

Choi Kin Sang of Messrs Au Choi Yuen & Co, Certified Public Accountants, for the taxpayer.

### **Decision:**

### **The appeal**

1. This is an appeal by Mr A ('the Taxpayer') against the determination of the Commissioner of Inland Revenue of 26 September 2000. The Taxpayer has objected to the salaries tax assessment for the year of assessment 1995/96. The Taxpayer claims that he should not be assessed to tax on a sum which he received from his employer on cessation of his employment and that the housing allowances from his employers should also not be included as part of his assessable income.

### **The facts not in dispute**

2. By a letter dated 19 January 1990, Company B offered and the Taxpayer accepted an appointment as executive vice-president on, among others, the following terms and conditions:

(a) 'Remuneration

(a) Salary

Your salary shall be \$65,000 per month, based upon 13 months per year. Your salary shall be subject to an annual review, taking account of the variations of the Hang Seng Cost of Living Index and of your own performance..?.

(b) 'Terms of Employment and Termination

(a) Your term of employment with Company B will commence on 1 March 1990 with a term of two years. Following the termination of the two-year service contract, Company B will have the option to negotiate a further term of two years service contract.

(b) Company B may terminate your employment by giving you three full months' notice in writing or three months' salary (pro-rated in case of notice less than three months) in lieu of notice. You are also under obligation to give three months' notice in writing to Company B in case of your own resignation. Company B may however accept your resignation with immediate effect.'

## INLAND REVENUE BOARD OF REVIEW DECISIONS

3. By a letter dated 3 February 1992, the Taxpayer's employment contract was renewed. The terms and conditions of the employment remained unchanged with some exceptions including the following:

- (a) The Taxpayer's salary would be \$75,000 per month, based upon 13 months per year.
- (b) The term of employment effective 7 February 1992 would be a permanent one.

4. By a termination agreement dated 3 July 1995 ('the Termination Agreement'), the Taxpayer and Company C-Finance Services agreed to certain terms governing the termination of the Taxpayer's employment. The terms included, among others, the following:

- (a) 'The parties hereby agree to terminate the service agreements between the parties executed on 19 January 1990 and 3 February 1992 and all other employment relationships between [the Taxpayer] of the first part and [Company C-Finance Services] and/or members of Group C of the second part (collectively referred to as the "Service Agreement") with effect from 1 July 1995.'
- (b) The Taxpayer should be paid a sum \$2,310,000 'as full and final settlement of all claims (present or future) for all remuneration (accrued or unaccrued, statutory or otherwise) in relation to the Service Agreement, including but not limited to:
  - (a) commission, salary, double pay, severance pay, long service pay, annual leave entitlement, sick leave entitlement, bonus, retirement benefits and any other benefits in connection with the Service Agreement; and
  - (b) any outstanding options granted under any stock option schemes of Group C.'
- (c) 'The Company shall procure provident fund with scheme number XXXXXXXXXXXX to pay to [the Taxpayer] his vested benefit under the scheme in an amount not less than \$199,888 in the ordinary course of operation of the scheme.'
- (d) '...subject to the confidentiality provisions contained in clause 6 below, it is confirmed that [the Taxpayer] shall be free to engage in any business, employment and activity after the termination of the Service Agreement whether in competition with Group C or otherwise.'

INLAND REVENUE BOARD OF REVIEW DECISIONS

5. In its notification dated 5 July 1995, Company C-Securities, a subsidiary of Company B, disclosed particulars relating to the Taxpayer's employment including:

- |  |   |                                    |
|--|---|------------------------------------|
| (a) Capacity in which employed                           | : | Managing director                  |
| (b) Period of employment                                 | : | 1-4-1995 to 30-6-1995              |
| (c) Reason for cessation of employment                   | : | Resignation                        |
| (d) Income   |   | \$                                 |
| Salary   |   | 156,000                            |
| Payment in lieu and all compensation ( ' the Lump Sum' ) |   | <u>2,310,000</u>                   |
| Total  |   | <u><u>2,466,000</u></u>            |
| (e) Quarters provided                                    |   |                                    |
| Period   | : | April 1995 to June 1995            |
| Address  | : | 1/F of House D ( ' the Property' ) |
| Rent paid to landlord by employer                        | : | \$159,000                          |

6. The employer's return of remuneration and pensions submitted by Company E in respect of the Taxpayer for the year ended 31 March 1996 showed, among others, the following particulars:

- |                                    |   |                          |
|------------------------------------|---|--------------------------|
| (a) Capacity in which employed     | : | Deputy managing director |
| (b) Period of employment           | : | 1-7-1995 to 31-3-1996    |
| (c) Income                         |   |                          |
| Salary                             |   | <u>\$528,493</u>         |
| (d) Quarters provided              |   |                          |
| Period                             | : | 1-7-1995 to 31-3-1996    |
| Address                            | : | the Property             |
| Rent refunded to employee          | : | \$477,000                |
| Rent paid to employer* by employee | : | \$477,000                |
- \* ' employer' should read as ' landlord'

7. In his tax return for the year of assessment 1995/96, the Taxpayer declared the same particulars of income and quarters provided as those set out in paragraphs 5 and 6 above, except the following:

- |  |  |              |
|--|--|--------------|
| (a) A breakdown was given in respect of the Lump Sum as follows: |  | \$           |
| Bonus and commission   |  | 1,000,000    |
| Payment in lieu of notice and compensation for loss              |  | _____        |
|  |  | <u>_____</u> |

INLAND REVENUE BOARD OF REVIEW DECISIONS

of office ( ' the Sum' )	1,310,000
Total	2,310,000

The Sum was not offered for assessment.

(b) In relation to the quarters provided by Company E:

Rent paid to landlord by employer	\$477,000
Rent paid by employee to employer	Nil
Rent refunded to employee	Nil
Rent paid to landlord by employee	Nil

8. The assessor was of the view that all the emoluments shown in paragraphs 5 and 6 above, including the Lump Sum, should be charged to salaries tax, and that the alleged rents paid by Company C-Securities and Company E were part of the Taxpayer's income also chargeable to salaries tax. He accordingly raised on the Taxpayer the following salaries tax assessment for the year of assessment 1995/96:

	\$
Income from Company C-Securities (\$2,466,000 + \$159,000) [paragraph 5]	2,625,000
Income from Company E (\$528,493 + \$477,000) [paragraph 6]	<u>1,005,493</u>
	<u>3,630,493</u>
Tax payable thereon	<u>544,573</u>

9. Messrs Au Choi Yuen & Co ( ' the Representatives' ), on behalf of the Taxpayer, objected against the salaries tax assessment for the year of assessment 1995/96 on the grounds that the Sum was not a taxable income and that the rental payment should be treated as if quarters were provided by the Taxpayer's employers.

10. In support of their objection, the Representatives submitted a letter dated 6 July 1996 issued by Company C-Securities to the Representatives. In this letter, Company C-Securities confirmed that the payment of the Lump Sum to the Taxpayer was made in pursuant to the Termination Agreement and the allocation in respect of the Lump Sum was in the manner as shown in paragraph 7(a) above.

11. In response to the assessor's enquiries, Company C-Securities provided the following information and documents:

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (a) The Taxpayer's employment commenced on 7 February 1990.
- (b) The Taxpayer resigned voluntarily.
- (c) ' We could not recall when we were informed by [the Taxpayer] verbally of his resignation. Our files do not record this matter. However, it should be within the month before 3 July 1995 which was the date of the Termination Agreement.'
- (d) ' Although [the Taxpayer] had not stated any reason for his resignation in writing, we understood that [the Taxpayer] resigned to assume a senior position in another financial firm.'
- (e) Mr F, the then Chairman of Company C-Financial Services, accepted and approved the resignation of [the Taxpayer].'
- (f) Of the Lump Sum, '\$1,000,000 was treated as bonus and commission and \$1,310,000 was treated as payment in lieu of notice and compensation for loss of office. The total amount of compensation and the breakdown of compensation were agreed between Company C-Securities and [the Taxpayer] through negotiation. There was no particular basis or formula of calculation.'
- (g) ' The payment [of the Lump Sum] was not made in accordance with the provisions of the Employment Ordinance. Instead, it was a negotiated amount of compensation.'
- (h) A copy of the termination statement in respect of the Taxpayer to show that the contributions for April 1995 to June 1995 were \$7,350 for each of these months and that the Taxpayer's vested benefit under the provident fund was \$203,112.
- (i) ' During the period from 1 April 1995 to 30 June 1995, [the Taxpayer's] monthly salary was \$52,000. He was also entitled to a housing allowance of \$53,000 per month. Accordingly, [the Taxpayer's] total monthly compensation during the period was \$105,000.'
- (j) ' There was no control exercised by [Company C-Securities] to ensure that the rent refund was actually expended by [the Taxpayer] in the payment of rent.'
- (k) ' The housing allowance was paid directly to [the Taxpayer].'
- (l) A copy of Company C-Securities' letter dated 31 December 1994 to the Taxpayer in which it was stated that the Taxpayer's monthly salary would be increased to \$105,000 with effect from 1 January 1994.



## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (m) A copy of Company C-Securities' internal memorandum dated 24 January 1994 by which the Taxpayer informed the personnel department that his housing allowance would be allocated as \$53,000 per month.
- (n) 'The internal memorandum ...was the only document regarding the monthly housing allowance of \$53,000 of [the Taxpayer]. Although the memorandum did not specifically refer to [the Property], it was the understanding between Company C-Securities and [the Taxpayer].'
- (o) A copy of an unstamped tenancy agreement dated 28 June 1993 between the Taxpayer as the tenant and Company G as the landlord whereby Company G purported to let the Property and 2/F of House D ('the 2/F Property') at a monthly rent of \$45,000 for two years from 1 July 1993 to 30 June 1995.

12. In response to the assessor's enquiries, Company E provided the following information and documents:

- (a) The Taxpayer commenced employment with Company E on 1 July 1995.
- (b) A copy of service agreement dated 7 August 1995 was entered into between the Taxpayer and Company E. It was agreed in this service agreement that the Taxpayer was appointed as the deputy managing director and, among others, that the Taxpayer should receive a salary (inclusive of a housing allowance in such amount as Company E and the Taxpayer might from time to time agree) at the rate of \$120,000 per month and a 13<sup>th</sup> month payment of \$120,000 at the end of the Chinese lunar calendar year.
- (c) During the year ended 31 March 1996, the Taxpayer was paid a monthly salary of \$52,000 and a housing allowance of \$53,000 was paid by Company E to Company G.
- (d) The housing allowance was based on the agreement between the Taxpayer and Company E. It would only be made to the landlord upon the presentation of the debit notes from the landlord.
- (e) The housing allowances of \$53,000 for the months from July 1995 to April 1996 at the rate of \$53,000 per month were paid to Company G by cheque.
- (f) Copies of the debit notes issued by Company G in respect of rental of the Property for the months from July 1995 to April 1996.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

13. (a) Company G is a private company incorporated in Hong Kong. At the relevant time, the paid up capital of Company G was equally owned by the Taxpayer and Ms H, the wife of the Taxpayer. They were also the only directors of Company G.
- (b) Company G's audited accounts for the year ended 31 December 1995 showed that its only income was rental income of \$636,000. Net loss of \$479,895 was reported for this year.
- (c) The Property and Carpark No 1 of House D were assigned to Company G on 8 January 1986.
- (d) The 2/F Property and Carpark No 2 of House D was assigned to Company G on 5 July 1993.

14. The assessor ascertained that on 27 October 1994, the Taxpayer was granted options to subscribe for 6,000,000 shares in Company C-International, the ultimate holding company of Company C-Securities, at an exercise price of \$0.81. The share options were exercisable within a period of two years commencing from 12 months after the date of acceptance. These options lapsed on 1 July 1995 upon the resignation of the Taxpayer.

15. By a letter dated 4 December 1997, the Representatives, on behalf of the Taxpayer, gave the following contentions:

- (a) ' [the Taxpayer] would like to confirm that there has never been a voluntary resignation. His resignation, as advised by his employer, was only a result of a compromise, which is indeed a very common practice in corporation for dealing with the leaving of the senior officers of the corporation in order not to affect the image of both parties.'
- (b) The Taxpayer's leaving ' was due to the dispute and disharmony between the management and [the Taxpayer]' . Copies of extracts from the financial sections of some newspapers to support the Taxpayers' claim were submitted.
- (c) ' [the Taxpayer] remembered that he has never submitted any resignation letter, except that some documents for the resignation of a company director to be filed with the Companies Registry, ... this further strengthened [the Taxpayer's] claim that there has never been a voluntary resignation which if true will certainly have a resignation letter from [the Taxpayer].'
- (d) ' there has never been any wordings in the [Termination Agreement] mentioning that the payment [of the Lump Sum] is for past services.'

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (e) ‘ As the housing allowance was paid by [the Taxpayer’ s] employer to the Landlord directly and [the Taxpayer] has no direct access to the rental payment and this have been reported by [the Taxpayer’ s] employer in the employer’ s return, the rental received by the Landlord has been reported as income in the Landlord’ s accounts, [Company G] ..’.

### **The evidence**

16. The Taxpayer attended the hearing and chose to given sworn testimony.

17. The Taxpayer explained to the Board the reason which caused his departure from Company C-Securities. He told the Board that the two groups of major shareholders in Company C-Securities had a dispute between them since early 1994. He and some of his colleagues were placed in the middle of the dispute. After it ended, Mr F’ s family remained and felt uncomfortable with the old management which, they thought, knew too much about the dispute. They began making things difficult for them. There were complaints about him spending too much time at the Council of the Stock Exchange of Hong Kong of which he was then a council member. His relationship with some of the senior officials deteriorated to the extent that they finally came to an agreement that he should leave. The time for his departure was not set. It was a gentleman’ s agreement. It was agreed that he would leave when he was able to find a position which would accommodate him as a council member of the Stock Exchange of Hong Kong. He refuted the statements in some newspapers that he and his colleagues tendered resignation. He explained that even though the company wanted him to leave, for record purpose he was not dismissed because a formal dismissal would damage his reputation in the stock-broking industry. It was a gentleman’ s agreement that he was to leave on the basis of a resignation on his part. He had never tendered a letter of resignation to the company. He left Company C-Securities as soon as he was engaged by Company E.

18. The terms of the Termination Agreement were negotiated on his behalf by Mr I, a colleague senior to him. Mr I informed him of the amount of the payment, but he had no idea how the Lump Sum was apportioned between the bonus and the compensation for loss of office. The figures of the apportionment were given to him after the Representatives made inquiry with Company C-Securities. Although he did not know how the apportionment was arrived at, it was understood between the parties that the termination payment should include a bonus and also compensation for loss of office. He considered that he suffered loss because when he left Company C-Securities, he lost a whole team of sales personnel which he brought with him when he joined Company C-Securities.

19. The Taxpayer told the Board that his remuneration from Company C-Securities included a housing allowance although it was not stated in the contract. It was mutually agreed between him and Company C-Securities that he would be reimbursed the rental payment upon his

## INLAND REVENUE BOARD OF REVIEW DECISIONS

presentation to the company a debit note. He explained that Company C-Securities credited Company G's account with the monthly rent through autopay because Company C-Securities agreed with him to pay the landlord direct if he could produce a debit note from the landlord. Thus, upon his production of the debit notes, Company C-Securities paid Company G direct. He believed that the housing benefits were not mentioned in his contract so as to avoid bad feelings among other employees because it was not Company C-Securities' normal practice to provide its employees with housing benefits. He could not confirm whether the tenancy agreement submitted by him to Company C-Securities was unstamped or not, as all the matters related to the tenancy were handled by his secretary. The tenancy agreement was not stamped at the time because he was wrongly advised that a tenancy agreement was valid without being stamped. He disagreed that his housing benefits from Company C-Securities were artificial arrangements. He stated that the housing benefits were agreed upon when the terms of his employment were discussed.

20. He explained that he had the same arrangements with Company E on the housing benefits. The arrangements were that he would be reimbursed with the monthly rental and the company would pay the landlord direct on production of a debit note. He could not recall whether there was a tenancy agreement entered into by him with Company G for the period commencing July 1995. The debit notes were issued to him and not Company E because he was the tenant of the rented properties. He said that the housing benefits from Company C-Securities and Company E were not artificial arrangements. He did not claim tax exemption on housing benefits after he joined Company J because Company J could not agree with him on the housing benefits. He denied that he avoided payment of tax artificially.

### **The Respondent's case**

#### **The Sum**

21. The Respondent contended that the Taxpayer resigned voluntarily and according to the Termination Agreement, the Lump Sum was paid in full and final settlement of all the Taxpayer's claims of remuneration under the Service Agreement. Since the whole of the Lump Sum was sourced from the Taxpayer's employment with Company C-Securities, in adopting the wider approach as mentioned in D24/97, IRBRD, vol 12, 195, the Sum was subject to salaries tax.

#### **The sums of \$159,000 and \$477,000**

22. It is the Respondent's case that the Taxpayer had failed to prove that the sums of \$159,000 and \$477,000 were rental allowances. It contended that both Company C-Securities and Company E did not intend to provide the Taxpayer with a place of residence and that the issue of monthly debit notes to the Taxpayer and the monthly payments made to Company G's bank account were insufficient proof of the alleged landlord and tenant relationship between Company G and the Taxpayer. The Taxpayer, by labeling part of his salary payment as rental payment, sought to obtain beneficial treatment under section 9(1)(b) and 9(1A) of the IRO. Furthermore, the

## INLAND REVENUE BOARD OF REVIEW DECISIONS

tenancy agreement dated 28 June 1993 and the alleged letting arrangements were artificial transactions and should be disregarded. At the material times, the Taxpayer and his wife were the only shareholders of Company G which in turn owned the rented properties. Thus, there was no commercial reason to justify the renting of the properties by the Taxpayer from Company G.

### **The Taxpayer's case**

#### **The Sum**

23. The resignation was not voluntary. The Sum comprised payment in lieu of notice and compensation for loss of office.

24. The senior management of Company C-Securities was desirous of introducing a new management cabinet to replace the old one including the Taxpayer. The same was reported in the newspapers. The dismissal took the form of resignation to preserve the image of both parties.

25. Had it been a resignation, Company C-Securities was not required to make a termination payment. The fact that the Lump Sum was paid suggested that there had not been a resignation and a payment in lieu of notice and compensation for loss of employment were involved.

26. At the material times, the Taxpayer was a council member of the Stock Exchange of Hong Kong. He could not be unemployed or leave the stock-broking industry during his office in the Stock Exchange. Under those circumstances, he joined Company E immediately upon leaving Company C-Securities.

#### **The sums of \$159,000 and \$477,000**

27. The transactions were neither artificial nor fictitious. All the parties concerned fully intended to carry out their obligations as evidenced by the monthly rental fee notes, the payments effected, the accounting records of Company G and the tax returns submitted to the Inland Revenue Department.

28. Company C-Securities and Company E paid the rents to Company G upon presentation of the rental debit notes. In this way due control was exercised by the employers regarding the rental benefits provided to the Taxpayer.

29. Both Company C-Securities and Company E intended to provide a rent-free place of residence to the Taxpayer. The housing benefits were included in the employment contract with Company E.

30. Section 9(1A)(b) is applicable to the present case and the housing benefits should be assessed in accordance with section 9(2).

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### The relevant statutory provisions

31. Section 8(1) of the IRO is the basic charging section for salaries tax. The section reads 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.’*

32. A definition of income from employment is provided in section 9(1) which reads:

*‘(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, ...*

*...*

*(b) the rental value of any place of residence provided rent-free by the employer or an associated corporation;*

*(c) where a place of residence is provided by an employer or an associated corporation at a rent less than the rental value, the excess of the rental value over such rent;*

*...’*

33. Section 9(1A) goes on to provide as follows:

*‘(1A) (a) Notwithstanding subsection (1)(a), where an employer or an associated corporation –*

- (i) pays all or part of the rent payable by the employee; or*
- (ii) refunds all or part of the rent paid by the employee, such payment or refund shall be deemed not to be income;*

## INLAND REVENUE BOARD OF REVIEW DECISIONS

*(b) a place of residence in respect of which an employer or associated corporation has paid or refunded all the rent therefor shall be deemed for the purposes of subsection (1) to be provided rent free by the employer or associated corporation.*

*...'*

34. Section 9(2) provides for the calculation of the rental value:

*'(2) The rental value of any place of residence provided by the employer or an associated corporation shall be deemed to be 10% of the income as described in subsection (1)(a) derived from the employer for the period during which a place of residence is provided...'*

35. Section 11D has the following provisions regarding the receipt of income:

*'For the purpose of section 11B –*

*(a) income which has accrued to a person during the basis period for a year of assessment but which has not been received by him in such basis period shall not be included in his assessable income for that year of assessment until such time as he shall have received such income, when notwithstanding anything contained in this Ordinance, an additional assessment shall be raised in respect of such income:*

*Provided that for the purposes of this paragraph income which has either been made available to the person to whom it has accrued or has been dealt with on his behalf or according to his directions shall be deemed to have been received by such person;'*

36. Section 61 empowers the assessor to disregard certain transactions as follows:

*'Where an assessor is of opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the person concerned shall be assessable accordingly.'*

37. Section 68(4) puts the burden of proof on the Taxpayer as follows:

## INLAND REVENUE BOARD OF REVIEW DECISIONS

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

### **Our findings**

38. The Respondent and the Representatives cited to us authorities for legal principles relevant to issues under this appeal. We will refer to those legal principles where necessary.

39. The authorities from the Respondent are:

- (a) Henley v Murray 31 TC 351
- (b) D19/92, IRBRD, vol 7, 156
- (c) D24/97, IRBRD, vol 12, 195
- (d) D33/97, IRBRD, vol 12, 228
- (e) D18/99, IRBRD, vol 14, 204
- (f) D77/99, IRBRD, vol 14, 528
- (g) D94/99, IRBRD, vol 14, 603

40. The authorities from the Representative are:

- (a) D3/97, IRBRD, vol 12, 115
- (b) D92/95, IRBRD, vol 11, 173

41. The Respondent has also presented us with a detailed written submission which we have considered carefully before reaching our decision.

42. With regard to the Sum paid to the Taxpayer by Company C-Securities upon termination of his employment, the issue for us to decide is whether the Taxpayer resigned voluntarily and the Sum was a payment by Company C-Securities on account of the Taxpayer's past services with the company or the Taxpayer resigned involuntarily and it was a payment as compensation to the Taxpayer for loss of employment.

43. The Respondent argued that the Taxpayer was not dismissed because the newspapers reported that the Taxpayer tendered his resignation; the fact that the Taxpayer joining Company E immediately upon his departure from Company C-Securities was consistent with the proposition that the Taxpayer resigned voluntarily; and as stated in the Termination Agreement, the Lump Sum was in settlement of all the Taxpayer's remuneration including share options benefits under the Service Agreement.

44. We have perused all the documents before us. We also have the benefits of seeing the Taxpayer and hearing his evidence. Having considered both the documentary and oral evidence, we are of the view that the Taxpayer did not resign of his own accord from his employment with



## INLAND REVENUE BOARD OF REVIEW DECISIONS

Company C-Securities. We accept the Taxpayer's evidence that there was disharmony between the senior management and the Taxpayer and some of his colleagues, as a result of which they came to an agreement that the Taxpayer should leave as soon as he found a new job and that Mr I negotiated the terms of the settlement on behalf of the Taxpayer. There is no evidence that the Taxpayer did tender a resignation. The Respondent relied on the newspapers reporting that the Taxpayer did resign or intended to resign of his own accord. We think we should not rely on these news reporting to find that the Taxpayer did resign voluntarily. In the commercial world, more often than not when an employee, especially if he holds a senior position in a company, is asked to leave the company by his employer, for various reasons, whether maintaining a harmonious relationship between the parties or preserving their images to outside parties or other reasons, the employee is often said to have resigned of his own accord. We believe that the present case falls within this kind of situation. Moreover, by its letter of 6 July 1996 and in its notification to the Revenue, Company C-Securities also confirmed that the Sum was a negotiated amount and it represented a payment in lieu of notice and compensation for loss of office. Company C-Securities apportioned the Lump Sum as bonus and compensation. Had there been a voluntary resignation on the part of the Taxpayer, negotiation and an apportionment would not arise. As to the Respondent's contention that in the Termination Agreement the Lump Sum was said to be in settlement of all remuneration under the Service Agreement, we think that it stands to reason that Company C-Securities should so describe the said payment. Since it was agreed between the parties that the Taxpayer was to resign of his own accord, surely the amount agreed to be paid by Company C-Securities could not have been put in the Termination Agreement as compensation for loss of office. Accordingly, on the facts of this case, we arrive at the conclusion that there was an involuntary resignation on the part of the Taxpayer and in consideration of his agreeing to leave, Company C-Securities agreed to pay him the Lump Sum a part of which was compensation for loss of office. Thus, although the Sum was paid to the Taxpayer as an employee, it was nonetheless compensation for loss of office and is therefore not taxable.

### **The sums of \$159,000 and \$477,000**

45. With regard to these two sums, the appeal involves a question of whether they were housing allowances or whether they were sums forming part of the income of the Taxpayer under the contracts of employment, irrespective of whether he incurred housing expenses of the same amounts.

46. The law in this regard is clear. A 'refund' of rent connotes a repayment or reimbursement, not mere payment (see D19/95, IRBRD, vol 10, 157). This means, in the typical case, that sufficient control must, as a matter of fact (not just in theory), be exercised by the employer over the payment so that the allowance is effectively a refund of rent and not just an additional emolument to be spent in any way that the employee may desire (see D33/97).

47. Based on the documentary and oral evidence, we find that the Taxpayer has failed to discharge the burden on him to prove that these sums were indeed housing allowances.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

48. We are not satisfied that Company C-Securities had exercised proper or sufficient control over how the alleged monthly housing allowance of \$53,000 was spent. According to the information supplied by Company C-Securities to the assessor, in its own admission, Company C-Securities did not exercise control to ensure that the allowance was actually expended by the Taxpayer in payment of rent. We find this statement correct because firstly Company C-Securities was prepared to entertain the Taxpayer's claim of housing expenses on the basis of an unstamped tenancy agreement and secondly, even though the rent was said to be \$45,000 per month in the tenancy agreement, Company C-Securities was prepared and did pay Company G \$53,000 per month as housing allowance. Even though the allowance was directly paid to Company G through autopay, we disagree that direct payment to the landlord equated with control by the employer on how the money was spent.

49. Apart from the lack of control on the use of the housing allowances, we also find other factors which support our view that the alleged housing allowances formed part of the Taxpayer's income and is taxable. The Service Agreement with Company C-Securities only provided the Taxpayer's salary. Provision of a quarter or housing allowance was not mentioned. The salary was said to be paid on the basis of 13 months per year. If the monthly sum of \$53,000 represented housing allowance, there should only be 12 payments and not 13 payments in a year in respect of this amount. Moreover, Company C-Securities' contribution towards its employees' provident fund was 7% of their salary and Company C-Securities' payment towards the Taxpayer's provident fund included 7% of the monthly allowance of \$53,000. Had the sum of \$53,000 been genuine housing allowance, it should have been excluded for the purpose of provident fund contributions. For these reasons, we find that the housing allowance paid by Company C-Securities to the Taxpayer was in reality part and parcel of his remuneration from the company.

50. We hold the same view on the housing allowance from Company E, notwithstanding that the service agreement provided that the salary was to include a housing allowance in such amount as from time to time agreed between the parties. The housing allowance was paid on a 13 month basis. The service agreement did not stipulate how the housing allowance should be expended. There was no evidence that Company E exercised control over how it was expended. The Taxpayer could not produce a written tenancy agreement covering the period from 1 July 1995 to 31 March 1996 nor could he recall whether a written tenancy agreement was ever entered into by him and Company G. Company E was prepared to make payment of the housing allowance to the Taxpayer without even a sight of a tenancy agreement. It is clear from this that control was not intended. The Taxpayer was paid the alleged housing allowance whether it was properly incurred or not. Thus, we find that the alleged housing allowances were in fact the Taxpayer's emolument.

51. Having found that the housing allowance from Company C-Securities and Company E formed part of the Taxpayer's salary, it is not necessary for us to consider whether or not the transactions between the Taxpayer and Company G were artificial or fictitious. If we had to do so, we would also find that the Taxpayer did not intend to create a legally binding landlord and tenant

## INLAND REVENUE BOARD OF REVIEW DECISIONS

relationship between himself and Company G since the Taxpayer did not seek to obtain proper advice on the validity of an unstamped tenancy agreement thus rendering the tenancy agreement not stamped until much later in 1997 and even though the tenancy agreement provided that the Taxpayer should pay the outgoings in respect of the rented property, we note from Company G's profit and loss accounts that all the outgoings were borne by Company G.

52. Accordingly, for the foregoing reasons, we allow the Taxpayer's appeal in respect of the sum of \$1,310,000 and dismiss his appeal in respect of the sums of \$156,000 and \$477,000.