

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D76/98

Salaries tax – claims arising from wrongful dismissal – settlement – whether settlement payment income from employment and liable to salaries tax – whether apportionable – whether apportionment reasonable.

Panel: Andrew Halkyard (chairman), Brian Hamilton Renwick and William Tsui Hing Chuen.

Date of hearing: 26 May 1998.

Date of decision: 19 August 1998.

The taxpayer had been employed by Company B but was summarily dismissed. The taxpayer claimed against the Company for wrongful termination of employment. The total claims amounted \$842,219 including \$209,706 as damages in lieu of notice. The claims were settled in the sum of \$315,000 (the Sum).

The assessor took the view that the Sum related partly to arrears of salary, bonuses, reimbursement of tax and paid leave and to that extent was liable to salaries tax. Upon objection by the taxpayer, the Commissioner upheld the assessor's view but revised that the salaries tax assessment by deducting \$78,432, being portionate part relating to damages in lieu of notice, from the Sum.

The taxpayer appealed against this determination on the grounds that no part of the Sum was liable to salaries tax.

Held:

1. The Board found the taxpayer made his claims under the terms of his employment with Company B. The Sum is taxable to the extent to which it represents income from employment (Carter v Wadman followed). Salary in arrears, leave pay and bonuses were all claimed by the taxpayer and fall within the definition of income from employment. These items were referable to the taxpayer's service under his employment with Company B. The only item not in the nature of income from employment was the payment in lieu of notice, that is, \$209,706.
2. The fact that the taxpayer did not get everything that he claimed and that the Sum falls far short of the total amount of his various claims does not change the nature of the Sum as being a payment which, in great part, represented

INLAND REVENUE BOARD OF REVIEW DECISIONS

compensations for non-receipt of certain items of income from employment (D24/97 considered).

3. As the Sum is of a mixed nature, the Commissioner is entitled to apportion the Sum between taxable and non-taxable components (Mairs v Haughey, Tilley v Wales & Carter v Wadman followed). The Sum was paid in settlement of distinct claims which were either liquidated or ascertainable by calculation. As such, it is proper for the Commissioner to apportion the Sum so as to ascertain the taxable portion (McLaurin v FCT followed).
4. The Board also found the Commissioner's basis of apportionment is fair and reasonable in the circumstances.

Appeal dismissed.

Cases referred to:

Mairs v Haughey [1993] STC 569
Tilley v Wales [1943] AC 386
D24/97, IRBRD, vol 12, 195
Carter v Wadman (1946) 28 TC 41
McLaurin v FCT (1961) 8 AITR 180

Cheung Lai Chun for the Commissioner of Inland Revenue.
Taxpayer in absentia.

DECISION:

Preliminary matters before the Board

Late appeal. Three preliminary matters arose before the Board proceeded to hear this appeal. First, the Commissioner did not object to the lateness of the Taxpayer's appeal. We agree. The Taxpayer's appeal to the Board was delayed as a result of non-delivery to him of the Commissioner's determination upon his objection. After receiving the determination, the Taxpayer lodged his appeal expeditiously. We therefore accepted that we had jurisdiction to hear the appeal.

Appeal heard in the Taxpayer's absence. The Taxpayer is now living in Country A. After several adjournments were granted to him, he applied for the hearing to be heard in his absence. We accepted this request and proceeded to hear the appeal in accordance with section 68(2D) of the Inland Revenue Ordinance.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Disclosure of potential conflict of interest. When the appeal papers were delivered to the Board, the Chairman discovered that the firm of solicitors acting for the Taxpayer's former employer in the employment dispute¹ with the Taxpayer was Baker & McKenzie. At all relevant times, the Chairman was a part-time consultant to that firm. The Chairman did not, however, have any knowledge of Baker & McKenzie's involvement in the employment dispute prior to receiving the appeal papers. He thereupon requested the Clerk to the Board to contact the Taxpayer to disclose the potential conflict of interest and to ask the Taxpayer whether he objected to the Chairman presiding over the appeal. The Taxpayer, having been contacted, did not object. He indicated to the Clerk to the Board that he wished the appeal to proceed without delay. At the commencement of the Board hearing the Chairman then disclosed all these matters to the Commissioner's representative. The representative also did not object to the Chairman's participation in the hearing.

The substantive issues before the Board

In the present appeal, the question for the Board's decision are:

- (1) The nature of a sum of \$315,000 ('the Sum') which the Taxpayer received from his former employer, Company B and
- (2) Whether the Sum or any part thereof is assessable to salaries tax for the year of assessment 1992/93, the year in which the Taxpayer's employment with Company B ceased.

The facts

We are indebted to the Commissioner's representative, Ms CHEUNG Lai-chun, who provided us with a statement of the basic facts relevant to this appeal. Although the facts were not in dispute, we independently verified Ms Cheung's statement by examining all the documents placed before us by both parties. In the event, we find the facts to be as follows.

1. The Taxpayer commenced his employment with Company B on 12 July 1982.
2. By a written contract of employment dated 7 November 1987 ('the Employment Contract'), the Taxpayer was appointed as general manager of Company B for a term of five years from 1 January 1988.
3. The Employment Contract provided, inter alia, that Company B shall pay to the Taxpayer the following:
 - (a) An annual remuneration package of \$334,000 comprising twelve months' salary, a Chinese New Year bonus equal to one month's salary and twelve month's housing allowance [clause 3.01];

¹ The income taxed to the Taxpayer concerned a payment related to this employment dispute.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (b) An annual increase of the remuneration package by 8% of the previous year's total remuneration package starting from 1 January 1989 [clause 3.02];
- (c) A bonus equal to 10% of the net profits earned by Company B in each financial year or a pro-rata amount thereof if the Taxpayer only served the company for a portion of such financial year [clause 3.03];
- (d) Two weeks' leave with full pay per year of service [clause 4];
- (e) An annual bonus of \$200,000 in respect of each period of service of twelve months in consideration of the Taxpayer agreeing to undertake the covenants concerning confidentiality and restraint of trade contained in clause 6 of the Employment Contract [clause 6.06(a)]; and
- (f) A special bonus payable at the end of the fifth year of service equivalent to the amount of any tax paid or payable by the Taxpayer in respect of his receipt of the annual bonus for each period of service of twelve months [clause 6.06(b)].

4. Clause 5.02 of the Employment Contract provided that the employment could be terminated at any time by either party giving to the other not less than six months' prior written notice. However, clause 5.03 provided that Company B could dismiss the Taxpayer without notice or payment in lieu of notice if the Taxpayer was guilty of or committed any serious misconduct. Upon such termination, the Taxpayer was not entitled to any payment (other than salary actually accrued, due and payable) for the then current year of service or to claim any compensation or damages by reason of such termination.

5. Clause 5.04 of the Employment Contract stipulated that if the employment was terminated other than under Clause 5.03, the Taxpayer would be entitled to salary and housing allowance actually accrued, due and payable and to a proportionate part of the Chinese New Year bonus and annual bonus but not to payment of any other compensation from the company in respect of such termination.

6. On 16 June 1992, Company B terminated the Taxpayer's employment.

7. On 29 July 1992, Company B notified the assessor that the Taxpayer had ceased to be employed and was about to depart from Hong Kong. The notification showed the following particulars:

- (a) Capacity in which employed: Director & General Manager
- (b) Reason for departure: Termination of employment contract
- (c) Period of employment from 1 April last to the date of cessation of employment: 1 April 1992 to 16 June 1992
- (d) Particulars of income: Salary/wages \$77,475

INLAND REVENUE BOARD OF REVIEW DECISIONS

Bonus	<u>132,369</u>
Total	<u>\$209,844</u>

8. In his salaries tax return for the year of assessment 1992/93, the Taxpayer declared the same total income as shown at fact 7.

9. Company B claims that the total income of \$209,844 comprised the following items:

(a)	Salary for April and May 1992 ($\$34,951 \times 2$)	\$69,902
(b)	Salary for the period from 1 to 16 June 1992	7,573
(c)	Bonus for the financial year 1991	<u>132,369</u>
		<u>\$209,844</u>

10. The Taxpayer accepted Company B's payment for item (a). Disputing quantum, he refused to accept Company B's cheques for items (b) and (c).

11. The Taxpayer believed that Company B had wrongfully dismissed him. On 31 July 1992, he lodged with the Labour Tribunal a claim against Company B for various sums totalling \$821,033. By an order dated 25 August 1992, the Labour Tribunal referred the case to the High Court for trial.

12. On 19 October 1992, the Taxpayer filed with the High Court a statement of claim in which he claimed from Company B loss and damages of \$352,503.36 (comprising salary, payment in lieu of notice, a proportionate part of the Chinese New Year and annual bonuses and payment in lieu of annual leave), the bonus under clause 3.03 of the Employment Contract for the financial year ending 31 December 1991, a proportionate part of such bonus for the period from 1 January 1992 to 16 June 1992 and interest, costs and other relief the Court might deem fit. He also asked for a declaration that the covenants contained in clauses 6.04 and 6.05 were void and unenforceable by Company B.

13. Company B denied most of the Taxpayer's claims and asserted that it lawfully and summarily dismissed the Taxpayer under clause 5.03 of the Employment Contract because the Taxpayer was guilty of misconduct in his employment. Company B particularised the alleged misconduct and breach of the terms of employment by the Taxpayer and counterclaimed from him damages for the losses it suffered as a result.

14. By an order dated 4 October 1993, the High Court granted leave to Company B to amend its defence and counterclaims. The Court also ordered that the trial of the action be adjourned to a later date and that the costs of a summons by Company B dated 23 September 1993 be awarded to the Taxpayer to be taxed and paid.

15. Pursuant to the High Court order dated 4 October 1993, Company B paid to the Taxpayer a sum of \$200,600 as costs and taxing fee on or around 23 March 1994. This amount is not in dispute in this appeal.

INLAND REVENUE BOARD OF REVIEW DECISIONS

16. As at 6 April 1994, the Taxpayer's total claims against Company B amounted to \$842,219.80 plus simple interest at 9% per annum from the due date of payment. The specific claims itemised by the Taxpayer were:

- (a) A sum of \$209,706 being six months' salary as damages in lieu of notice for wrongful termination of the Employment Contract;
- (b) A sum of \$18,640.53 as the arrears of salary for the period from 1 June 1992 to 16 June 1992;
- (c) A sum of \$16,043.08 as a proportionate part of entitlement to the annual Chinese New Year bonus;
- (d) A sum of \$200,000 as the annual bonus for the year 1992 for the Taxpayer having faithfully complied with the restraint of trade clauses in the Employment Contract;
- (e) The reimbursement of tax of \$150,000 as the amount of tax paid or payable by the Taxpayer in respect of the receipt of annual bonus for the years of assessment 1988 to 1992;²
- (f) Paid leave in the sum of \$8,738 as payment in lieu of 7.5 days' paid leave to which the Taxpayer claimed he was entitled; and
- (g) A bonus of \$239,092.20 being 10% of the net profit of Company B for the financial year 1991 and for the proportionate part of 1992, the amount being assessed by the Taxpayer.

17. On or before 22 April 1994, the Taxpayer and Company B agreed that Company B would pay the Sum of \$315,000 to the Taxpayer on an ex gratia basis with each party bearing their own costs in full and final settlement of the claims and counterclaims in the High Court action. It is this Sum which is the subject matter of this appeal.

18. On 11 May 1994, the High Court issued a consent summons inter partes pursuant to the agreement reached between Company B and the Taxpayer. On 12 May 1994, the High Court issued an order which stipulated, inter alia, that all further proceedings in the action be stayed except for the purpose of carrying into effect the following terms of settlement:

- (a) Company B shall make an ex gratia payment to the Taxpayer in the sum of \$315,000 in full and final settlement of the claims and counterclaims in the action, such payment to be made on 10 May 1994.

² This refers to the special bonus described at fact 3(f).

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (b) Company B agrees not to institute further court proceedings in respect of all current matters that were the subject of the employment dispute.
- (c) It is agreed that the payment of the Sum of \$315,000 is in full and final settlement of any and all costs and liabilities of either party to the other and no further order of the Court or enforcement of any existing order shall be sought in relation to any such liability existing at the date of the consent summons dated 11 May 1994.

Company B settled the Sum by a cheque dated 9 May 1994.

19. In response to the assessor's enquiries, Company B stated that it paid the Sum to the Taxpayer in full and final settlement of all claims and counterclaims including claims for payment in lieu of notice for termination of employment and compensation for loss of employment. Company B stated that the Sum was calculated on a commercial basis taking into account the anticipated level of legal costs the company would have incurred and that it paid the Sum without admission of liability.

20. The Taxpayer was unemployed for the period from 16 June 1992 to 31 December 1992. A company called Company C employed the Taxpayer as director and general manager with effect from 2 January 1993. The Taxpayer's income from Company C for the period from 2 January 1993 to 31 March 1993 was \$49,500.

21. The assessor took the view that the Sum related partly to arrears of salary, bonuses, reimbursement of tax and paid leave and to that extent was liable to salaries tax. Upon objection by the Taxpayer, the Commissioner upheld the assessor's view and determined that the salaries tax assessment for the year of assessment 1992/93 raised on the Taxpayer should be revised as follows:

Income from Company B		
- Salary for 1.4.1992 to 31.5.1992 ($\$34,951 \times 2$)		\$69,902
- Sum received from Company B	\$315,000	
Less: Proportionate part relating to damages in lieu of notice ($\$315,000 \times 209,706/842,219$) ³	<u>78,432</u>	<u>236,568</u>
		306,470
Income from Company C (fact 20 refers)		<u>49,500</u>
Assessable income		<u>\$355,970</u>

22. The Taxpayer appealed against this determination to the Board of Review on the grounds that no part of the Sum was liable to salaries tax.

The Taxpayer's contentions

³ \$209,706 = amount referable to 6 months' payment of salary in lieu of notice; \$842,219 = total claims made by the Taxpayer against Company B as at the time of the settlement (fact 16 refers).

INLAND REVENUE BOARD OF REVIEW DECISIONS

23. The Taxpayer detailed his grounds in his notice of appeal dated 2 August 1997 and in his letter to this Board dated 4 May 1998.

24. In essence, the Taxpayer claims that Company B paid him the Sum because the agreed not to pursue his claims further and not because Company B admitted liability to any of the claims arising from his previous employment with the company. On this basis, the Taxpayer argues that the Sum is not income from employment and therefore should not be assessable to salaries tax.

25. The Taxpayer further argues that apart from salaries, wages and bonus to which he considers he was entitled under the employment, he also claimed for interest and costs. He contends that even if the Sum was treated as paid to him in full and final settlement of all claims and counterclaims in the High Court action, it should not be regarded as income from employment. He argues that the whole sum is a receipt for an 'out of court' settlement and no part of it is in the nature of income from employment chargeable to salaries tax.

26. The Taxpayer also claims that the Sum was used up in defraying his legal expenses and as the monies should have been taxed in the hands of the recipient law firms, he should not be taxed on the same sum.

27. Finally, the Taxpayer claims that his legal expenses exceeded the Sum he received from Company B. He thus contended that the Commissioner's determination, which only excluded the amount of \$78,432 from salaries tax, was neither fair nor sufficient to cover the legal costs he incurred. The Taxpayer claims that his assessable income for the year of assessment 1992/93 should be computed as follows:

Salary from Company B for April and May 1992	\$69,902
Income from Company C for the period from 2 January 1993 to 31 March 1993	<u>49,500</u>
Assessable income	<u>\$119,402</u>

The Commissioner's contentions

28. The Commissioner contends that there is no provision in the Inland Revenue Ordinance ('the IRO') which states that a receipt for an 'out of court' settlement is not chargeable to salaries tax. The IRO charges salaries tax on income from employment. If the Sum or any part of it is income from employment, then the Sum or the relevant part thereof is assessable to salaries tax. Where it can be shown that no part of the Sum is income from employment, the whole sum is not assessable to salaries tax.

29. In the present case, save and except for that part relating to payment in lieu of notice for termination of employment, the Commissioner took the view that the Sum is income from employment. The Commissioner argued that:

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (a) The Taxpayer as an ex-employee claimed against Company B for various sums pursuant to the terms of his employment with the company;
- (b) The Taxpayer's claims arose directly from his employment with Company B;
- (c) Company B as an ex-employer put forward its counterclaims against the Taxpayer pursuant to the terms of the Taxpayer's employment;
- (d) Company B's counterclaims arose directly from the Taxpayer's employment with it;
- (e) The Sum was paid in settlement of the Taxpayer's claims and Company B's counterclaims;
- (f) The source of the Sum was the Taxpayer's employment with Company B;
- (g) The Sum was paid to the Taxpayer to satisfy his claims for various sums;
- (h) The Sum derived its character from the nature of the various sums it replaced;
- (i) The Sum was paid in settlement of the Taxpayer's claims for the following items: payment in lieu of notice for termination of employment, salary in arrears, leave pay and bonuses;
- (j) Payment in lieu of notice is made to terminate an employment and is thus not income from employment whereas salary in arrears, leave pay and bonuses are;
- (k) The Sum derived its character at least from the several items of income from employment it replaced and is therefore assessable;
- (l) Where a sum is paid partly for a taxable purpose and partly for a non-taxable purpose, the payment should be apportioned so that only that part relating to income from employment should be taxed; and
- (m) Out of the Sum of \$315,000, an amount of \$236,568 which is computed by reference to the proportion which the Taxpayer's claims for those items of income from employment bears to the total amount of his claims (excluding interest and costs, details of which are not supplied) is assessable to salaries tax.

The relevant statutory provisions

30. Section 8(1)(a) of the IRO provides that:

'Salaries tax shall ... be charged for each year of assessment on every person in respect of his income ... from ... any office or employment of profit;'

INLAND REVENUE BOARD OF REVIEW DECISIONS

31. Section 9(1)(a) of the IRO contains a non-exhaustive definition of income from employment as follows:

'(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 ...'

32. Section 68(4) of the IRO places the burden of proof on the Taxpayer as follows:

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

The applicable case law

33. In Mairs v Haughey [1993] STC 569 Lord Woolf, in determining whether an ex gratia payment received by an employee in lieu of his contingent right to receive a non-statutory redundancy payment was an emolument from employment, said at pages 577 and 579:

'... the total payment was made for the two separate identifiable considerations [namely] (1) the new terms and conditions of employment and (2) the termination of the enhanced redundancy scheme. It is true that neither of the two elements are exclusively referable to either element of the consideration. However ... if the payments were being paid for two considerations, the commissioner was entitled apportion the payments between the considerations (see Tilley v Wales), and, this being so, it cannot be said that the apportionment adopted was wrong.'

'It is inevitable that if a payment is made in substitution for a payment, which might, subject to a contingency, have been payable [then] the nature of the payment which is made in lieu will be affected by the nature of the payment which might otherwise have been made.'

'Prima facie a payment made after the termination of employment is not an emolument from that employment. It can be, however, an emolument from the employment if for example it is a lump sum payment in the nature of deferred remuneration ... [In] order to determine whether this is the situation it is necessary to look at the substance of the matter. If a payment relates to the services rendered then the fact that the payment is made after employment comes to an end does not mean that it is divorced from the employment.'

34. Where an amount paid as compensation for termination of employment is less than the amount claimed, but each of the claims is for a liquidated amount of damages, English courts have been prepared to apportion the compensation paid on a pro rata basis

INLAND REVENUE BOARD OF REVIEW DECISIONS

and tax the proportional income amount, provided that the proportion which each claim bears to the total amount of compensation paid can be readily ascertained: see Tilley v Wales [1943] AC 386.

35. In D24/97, IRBRD, vol 12, 195 the Board of Review, when deciding whether a sum payable under the taxpayer's employment contract on termination of employment but at a lesser amount based on a compromise with the employer was assessable to salaries tax, said at pages 202 and 203:

'The dispute as to the amount cannot change the nature of the payment. If the original entitlement under the contract is taxable, it does not become non taxable because the parties reached a settlement on the amount payable.'

36. In Carter v Wadman (1946) 28 TC 41 Lord Greene, MR drew a distinction between a payment made as damages for the repudiation of a service agreement under which the claims were not in any way settled or discharged but altogether withdrawn and a payment made partly for the cancellation of a service agreement and partly in settlement of all past, present and future claims. It was held that a lump sum paid to the taxpayer to terminate his service agreement and expressed to be 'in full settlement of all past, present and future claims' was assessable to the extent to which it represented a profit from employment. Lord Greene said at pages 52 and 53:

'In the present case the £2,000 does not purport to be paid as damages. It is, no doubt, in part the price of the cancellation of the agreement, but it is also ... paid partly in settlement of past and then present claims. One of those claims was the claim to a fourth part of the profits of the business down to 2nd December, 1942. The taxpayer's right to this claim was, in our opinion, clearly a profit arising from an employment of profit within Schedule E ... [We] respectfully agree with their Lordships [in Tilley v Wales (1943) 25 TC 136] that in principle there must be apportionment ...'

37. In McLaurin v FCT (1961) 8 AITR 180, the High Court of Australia dealt with the chargeability of a lump sum that was paid in full settlement of a claim in respect of damage done to the taxpayer's grazing property by a bush fire. The lump sum was calculated with reference to specific items of damage the details of which were not supplied to the taxpayer. The court denied that an apportionment was proper on the facts of the case and said at page 191:

'It is true that in a proper case a single payment or receipt of a mixed nature may be apportioned amongst the several heads to which it relates and an income or non-income nature attributed to portions of it accordingly [authority cited]. But while it may be appropriate to follow such a course where the payment or receipt is in settlement of distinct claims of which some at least are liquidated: cf. Carter v Wadman (1946) 28 TC 41; or are otherwise ascertainable by calculation: cf. Tilley v Wales [1943] AC 386; it cannot be appropriate where the payment or receipt is in respect of a claim or claims for

INLAND REVENUE BOARD OF REVIEW DECISIONS

unliquidated damages only and is made or accepted under a compromise which treats it as a single, undissected amount of damages.'

Analysis

38. The Taxpayer contends that the Sum is not assessable to salaries tax because it is a lump sum paid for an 'out of court' settlement. He states that he was paid the Sum because he agreed not to litigate further and not because Company B admitted any of his claims. However, on the facts before us, the Sum was paid in full and final settlement of the Taxpayer's claims and Company B's counterclaims (see facts 17-19). Does it then follow that the Sum cannot be income from employment? We think not. Our analysis follows.

The source of the Sum

39. In the present case, the Taxpayer had an employment with Company B. Under the terms of his employment, he was provided with a remuneration package consisting of a salary, a Chinese New Year bonus and a profit bonus. He was also entitled to certain leave with full pay, an annual bonus and a special bonus. Company B terminated the Taxpayer's employment. The Taxpayer took legal action and claimed from Company B various amounts, namely, payment in lieu of notice for termination of employment, salary in arrears, leave pay and bonuses.

40. The Commissioner states that whether or not Company B's dismissal of the Taxpayer constituted a wrongful dismissal as claimed by the Taxpayer, the items claimed by him were part of his remuneration package under the terms of his employment contract. We agree. It is clear that, at all times, the Taxpayer made his claims under the terms of his employment with Company B. His claims arose solely from his employment with Company B.

41. We appreciate that the Taxpayer did not get the various sums he claimed but was paid the Sum in full and final settlement of his claims and Company B's counterclaims. However, as indicated above, all his claims arose from his employment with Company B. There is no evidence that the Taxpayer received the Sum in any other capacity than that of employee. In all the circumstances, we agree with the Commissioner that the source of the Sum can only be the Taxpayer's employment with Company B.

Does the Sum represent income from employment?

42. In this case the claims and counterclaims were not withdrawn but settled by a payment. Following the decision in Carter v Wadman the Sum is taxable to the extent to which it represents income from employment. And, borrowing the reasoning in Mairs v Haughey, the Sum derived its character from the nature of the various sums it replaced. Salary in arrears, leave pay and bonuses were all claimed by the Taxpayer and all fall within the definition of income from employment. These items were referable to the Taxpayer's services under his employment with Company B. It follows that to the extent it covers these

INLAND REVENUE BOARD OF REVIEW DECISIONS

income items, the Sum represents income from employment. It is prima facie chargeable to salaries tax.

43. On the facts before us, there is no dispute that upon termination of his employment the Taxpayer was owed various amounts by Company B, including salary in arrears (for the period 1 to 16 June 1993) and annual bonus (for the year ended 31 December 1991). These items are in the nature of deferred remuneration and, to the extent received, would clearly be taxable income from the Taxpayer's employment. The Taxpayer disputed the quantum of the payments offered by Company B (fact 10 refers). Having made his own calculations, he then claimed these and other amounts from Company B. In the event, he received the Sum under an 'out of court' settlement and now contends that the whole amount should not be taxed because it is not income from employment. We do not agree. As indicated above, the Sum, which was expressly paid and received in full and final settlement of the Taxpayer's claims against Company B, takes its nature from the *substance* of those claims. To a large extent those claims represent items of income which would have been liable to salaries tax if received in the normal course.

44. It is true that the Taxpayer did not get everything that he claimed and that the Sum falls far short of the total amount of his various claims. However, this does not change the nature of the Sum as being a payment which, in great part, represented compensation for non-receipt of certain items of income from employment. As pointed out in D24/97, the dispute between an employee and his employer could not have changed the nature of the payment the employee finally received if some of the items he originally claimed pursuant to the terms of his employment would be taxable. We therefore agree with the Commissioner that the payment in the present case would not become non-taxable simply because the Taxpayer and Company B reached a settlement (albeit an 'out of court' settlement) of the amount payable.

Is apportionment proper in this case?

45. In the present case, although the Sum is a single payment, it is of a mixed nature. If part only of the Sum represents income from employment, then we must consider whether the Commissioner is entitled to apportion such a payment between taxable and non-taxable components? In our view, the answer should be yes. The decisions of Mairs v Haughey, Tilley v Wales and Carter v Wadman point to the possibility of apportioning a payment laid out for a combination of purposes, some being taxable and some non-taxable.

46. In this regard, we also agree with the Commissioner that the decision of McLaurin v FCT supports an apportionment in the present case. The High Court of Australia in McLaurin said that it might be appropriate to dissect a payment amongst the various heads to which it relates and attribute an income or non-income nature to portions of it where the payment or receipt is in settlement of distinct claims of which some at least are liquidated or are otherwise ascertainable by calculation. Both of these conditions are satisfied in this case.

INLAND REVENUE BOARD OF REVIEW DECISIONS

47. The Sum was paid in settlement of distinct claims, some of which were liquidated. For instance, the Taxpayer was entitled to salary in arrears for the period from 1 to 16 June 1992 and the profit bonus for the financial year ending 31 December 1991 under the terms of his employment contract whether or not he was lawfully dismissed or wrongfully dismissed. The claims (except for interest, costs and other relief which the Court might think fit to grant) are also ascertainable by calculation because each of them was itself calculated on a specific basis by reference to the terms of the employment contract. As such, we agree that it is proper for the Commissioner to apportion the Sum so as to ascertain the taxable portion.

Is the basis of apportionment adopted reasonable?

48. The remaining question is whether the Commissioner's basis of apportionment is fair and reasonable in the circumstances. We think it is. Just prior to the settlement, the Taxpayer's claims against Company B (excluding cost and interest) amounted to \$842,219.80. Of this, the only item not in the nature of income from employment was the payment in lieu of notice of \$209,706. The other items all relate to income from employment. A natural course to ascertain the taxable part of the Sum is to apportion it by reference to the proportion the income items bear to the total claimed. The taxable portion so computed would be \$236,568 as determined by the Commissioner.

49. The Taxpayer claims that the Commissioner's decision to only exclude from the charge to tax the sum of \$78,432 (which represents a proportionate part relating to the payment in lieu of notice) is not fair because it hardly covers any of the legal costs he incurred in the litigation. We agree that this seems unfair. However, if as a matter of law the Sum or part thereof is income from employment, then it is liable to salaries tax. The quantum of the payment and whether it is taxable in the hands of some other persons after it is disposed of are irrelevant in determining its nature. The Taxpayer's only possible course of redress in this case is to consider whether his legal cost qualify for deduction under the provisions of section 12 of the IRO. He has never suggested that they do qualify; and indeed they do not.

Conclusion

50. On all the fact before us, we agree with the Commissioner that the true character of the Sum in dispute is partly in the nature of income from employment and is assessable to salaries tax to that extent. We thus consider that this is an appropriate case for apportionment and accept the basis of apportionment adopted by the Commissioner. The appeal is therefore dismissed.

51. It is left to us to thank Ms Cheung, The Commissioner's representative, for the thorough and detailed submission she place before us. It will apparent to both parties that we have made liberal use of this in our decision. We must note that Ms Cheung, as the sole representative at the hearing and in fairness to the absent Taxpayer, endeavoured to explain to us all his arguments in a measured and even-handed way. Our one regret is that, despite spirited arguments by the Taxpayer based on the facts and merits of this appeal, we did not

INLAND REVENUE BOARD OF REVIEW DECISIONS

have the advantage of hearing contrary legal submissions to those advanced on behalf of the Commissioner. Nevertheless, we looked closely at the authorities relied upon by the Commissioner; we also undertook our own research. In the result, we find no fault with the Commissioner's reasoning in this case.