INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D79/88

Interpretation – foreign cases – whether applicable.

Salaries tax – termination sum – gratuity paid to employee on resignation from employment – whether assessable – s 9(1)(a) of the Inland Revenue Ordinance.

Panel: Henry Litton QC (chairman), Alexander Au Siu Kee and Kenneth Ku Shu Kay.

Dates of hearing: 15 and 16 March 1989.
Date of decision: 30 March 1989.

The taxpayer resigned from his employment and received an ex-gratia payment from his employer. The payment was made pursuant to the employer's policy of making payments to employees on their resignations. Under this policy, the amount of the payment was calculated by reference to a formula which took into account the taxpayer's final salary and length of service with the employer.

Employees were not entitled to the gratuity under their contracts of employment, but the gratuity had been paid to all resigning employees over the last few years. Employees in fact were unaware of the existence of their employer's policy of paying such a gratuity.

The IRD assessed the taxpayer to salaries tax with respect to the gratuity. The taxpayer appealed.

Held:

The gratuity was 'income from employment' and was therefore subject to salaries tax.

(a) The word 'gratuity' connotes a gift usually given on account of past services.

(b) Where a termination payment is made on account of something else, such as in settlement of a claim for damages for wrongful dismissal or in the nature of compensation for loss of employment (for example, on an employee's dismissal), then the payment could not be regarded as a gratuity.

(c) The fact that a payment is described by the employer as a gratuity does not make it a gratuity where in fact it is not a gratuity.

(d) The facts that the payment was made pursuant to a long-standing consistent practice, was payable immediately upon the resignation taking effect and was calculated by reference to the taxpayer's salary and length of service supported the view that it was income from employment.

In the course of the hearing, the taxpayer referred to UK cases dealing with the interpretation of the Malaysian tax statute. The Board said that there was no value in resorting to cases dealing with the construction of foreign statutes when the provisions of the Inland Revenue Ordinance are clear and unambiguous.

Appeal dismissed.

Cases referred to:

Heywood v Comptroller-General of IR (Malaysia) [1974] STC 531
Hochstrasser v Mayes (1959) 38 TC 673

Luk Nai Man for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Introduction

1. The question for our decision in this appeal is this: Is an ex-gratia payment of $61,683 made to the Taxpayer by his employer upon the termination of his employment chargeable to salaries tax under section 8(1)(a) of the Inland Revenue Ordinance?

2. The Taxpayer was employed by a company ('the company') for a period of seven years, from 1 November 1979 to 31 October 1986 when he resigned.

3. In a notification lodged by the employer with the Inland Revenue Department, the details of the Taxpayer's emoluments from 1 April 1985 to 31 October 1986 were given as follows:

Salary/Wages	$231,320
Gratuities, etc	$ 61,683
Salaries Tax paid by employer	$ 19,965

4. The assessor treated the sum of $61,683 as a gratuity, as indeed the sum was so described in the employer's return and, applying the provisions of section 9(1)(a) of the Ordinance, assessed the sum as chargeable to salaries tax.

5. The relevant provisions of section 9(1) provide as follows:

> ' 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 …'

6. The contention on behalf of the Taxpayer, as put to us by his tax representative, was in essence as follows:

(i) the label 'gratuity' put upon the transaction by the employer is not conclusive;

(ii) when all the circumstances of the payment are examined, it will be seen that the income arose upon the termination of the Taxpayer's employment and was therefore not 'income from any office or employment of profit' within the meaning of the charge to salaries tax under section 8(1)(a) of the Ordinance.

Facts

7. During his employment with the company, the Taxpayer came within the company's retirement benefits scheme for foreign staff. Under that scheme, the Taxpayer was entitled to receive a pension after 15 years of service; but, as he resigned upon completion of only seven years' service, he was not entitled to, and did not receive, a pension.

8. After the Taxpayer gave notice of his intention to resign, the Board of directors of the company approved an ex-gratia payment to the Taxpayer as recommended by the management. This was pursuant to a policy laid down by the Board at a meeting many years before which approved a formula to be used when determining the gratuity to be paid to foreign staff members when leaving the service of the company at their own request.

9. The evidence which was adduced before us at the hearing also showed that:

(i) the policy of paying a gratuity to members of the foreign staff upon resignation was never a term of their service, was never published, and was regarded as something confidential and kept within the knowledge of the highest levels of management;

(ii) although the payment of gratuity in accordance with the formula was always considered by the company on a case-by-case basis (as in this case), there has

never been any instance where the company departed from the practice over the period of many years when the policy has been in operation.

10. The formula as laid down by the company for the payment of gratuity was calculated upon the final basis salary of the officer concerned and his length of service. Thus, the payment to the Taxpayer worked out as follows:

Final basic Salary per month $		Length of Service in year	%	Payment $
33,800	x	7	25	59,150
33,800	x	1	2.5	845
33,800	x	1	5	1,690
				$61,685

Conclusion

11. Upon these facts, it seems to us clear that the sum in question was a gratuity arising from the Taxpayer's employment of profit with the company. It arose from nothing else.

12. In the course of the hearing, we were referred to the English case of Hochstrasser v Mayes (1959) 38 TC 673 and also to decisions of the Privy Council such as Heywood v Comptroller-General of Inland Revenue (Malaysia) [1974] STC 531 concerning the Malaysian Income Tax Act 1967. We do not see the value of resorting to cases dealing with the construction of other statutes overseas when the provisions of the local statute which we have to construe are clear and unambiguous. The 'Malaysian' cases concern the distinction between 'gains or profits from employment' on the one hand, and 'compensation for loss of employment' on the other: the latter is expressly excluded from the charge to tax under schedule 6, part I, paragraph 15 of the relevant Malaysian statute. There is no such express exclusion in the Hong Kong Ordinance. It was conceded in argument by Mr Luk, the Commissioner's representative, that, under the scheme of the Hong Kong statute, if a payment (whether it be called a 'gratuity' or anything else) were made as compensation for the loss of employment, then it could not be said to be income from employment and hence would not be chargeable under section 8(1)(a) of the Ordinance. But, as Mr Luk argued, the present case is nowhere near such an example. We agree with this submission.

13. The Inland Revenue Ordinance lays down a relatively straightforward code for the imposition of tax. By the definition of 'income from employment' in section 9(1)(a), the statute specifically sweeps within the tax net payments received by an employee which can be categorised broadly as gratuities. The word 'gratuity' is an ordinary word in the English language and connotes a gift or present usually given on account of past services. Obviously, where the circumstances of the case show that the payment was made on account

of something else (for example, in settlement of a claim for damages for wrongful dismissal), then, whatever label is used, the payment cannot properly be regarded as a 'gratuity' in the ordinary sense.

14. In the present case, the stark facts are that:

(i) the payment was authorised by the board of directors of the company whilst the Taxpayer was still in the company's employment;

(ii) the payment was on account of the Taxpayer's resignation, not dismissal; there was no question of the payment being in the nature of 'compensation for loss of employment' which was what Heywood (above) was about;

(iii) the payment, although ex-gratia, was pursuant to a long-standing practice of the company which has been consistently applied ever since the policy was laid down many years ago, and never departed from;

(iv) the sum was payable immediately upon the resignation taking effect and the amount of the payment was calculated with reference to the Taxpayer's salary and length of service.

In these circumstances, the payment plainly comes within the charge to tax under section 8(1)(a). This appeal is accordingly dismissed.