Case No. D83/04

Salaries tax – sum received under recognized provident fund scheme – whether variation or rescission of employment contract – sections 8(2)(cc) and 9(1)(ab) of the Inland Revenue Ordinance ('IRO').

Panel: Ronny Wong Fook Hum SC (chairman), James Kwan Yuk Choi and Winnie Lun Pong Hing.

Date of hearing: 9 December 2004.
Date of decision: 17 February 2005.

The appellant commenced employment as a director of Company A on 1 July 1988. On 1 July 1990, Company A established a plan, a mandatory provident fund scheme within the meaning of sections 8(1) and 9(1)(ab) of the IRO.

On 12 July 2000, the appellant received a letter from Company A that his employment will come to an end by 30 November 2000 and the plan will terminate by August 2000.

In August 2000, the appellant received a sum of $1,117,836 of which $443,711 was Company A's contribution.

On 1 December 2000, the appellant was employed by Company A as director again.

The issue is whether the sum of $443,711 should by section 8(2)(cc) of the IRO be excluded in computing the income of the appellant under section 8(1) on the ground that it is a sum 'received from the approved trustee of a mandatory provident fund scheme on … termination of service' or whether the same should be regarded as income under section 9(1)(ab) of the IRO as an amount received by him under a recognized occupational retirement scheme 'otherwise than because of termination of service'.

Held:

The Board found the parties in this case clearly intended to bring the employment contract that subsisted on 12 July 2000 to an end. Three months notice was served for such termination. The employment contract came to an end on 30 November 2000. As a

result, the appellant became entitled to the payment in question in accordance with the terms of the plan. (D101/89 distinguished).

Appeal allowed.

Case referred to:

D101/89, IRBRD, vol 6, 375

Yeung Siu Fai for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The facts and the issue

1. The Appellant commenced employment as a director of Company A on 1 July 1988. There was no written document regulating the terms of his engagement.

2. On 1 July 1990, Company A established a '[Company A] Group Provident Fund Scheme' with the Insurance Company B. This was revised in April 1996 to become the 'Group Retirement Plan for Salaried Employees of [Company A]' ['the Plan']. It is common ground between the parties that the Plan was a 'mandatory provident fund scheme' within the meaning of sections 8(1) and 9(1)(ab) of the Inland Revenue Ordinance ['the IRO'].

3. The Plan provided as follows:

(a) For each month and in the case of a full-time service director, Company A was to contribute an amount equal to 15% of that director's monthly salary.

(b) Company A reserved the right to terminate the Plan by written agreement with Insurance Company B. Upon termination of the Plan due to discontinuance at Company A's written request 'the total unallocated assets under the Group Retirement Plan will be allocated to each Member at the date of discontinuance pro rata as his and the Employer's Accumulation on his behalf are of the total Member's and Employer's Accumulations of all Members. Such allocated amount will only be paid to the Member ... in the event of the Member's subsequent termination of employment ...'

(c) 'Member' was defined to mean 'an individual in the employ of [Company A] and shall include a director in the full time service of [Company A].'

4. On 12 July 2000, Company A sent to the Appellant a letter in these terms:

' We refer to the discussions in between the staffs and the Company Directors, due to enactment of MPF by end of 2000, it is the Company's decision that we have arranged to terminate the ORSO Scheme by 15 August 2000, and the present employment contract will be ceased by 30 November 2000.

1. Termination of ORSO scheme – 15 August 2000.
   (Group Policy No. [XXXXXXX-XXX]
   (ORSO Registration NO. [YYYYYYYY]

2. Last month contribution to ORSO Scheme – June, 2000

3. Notice of Employment Termination – 3 months
   (September 2000 – November 2000)

4. Date of Termination of Employment Contract – 30 November 2000

5. Benefits/Service Payment – Upon termination of the employment, [Insurance Company B] will arrange the payment of all vested benefits in full or the service payment under Labour Department Employment Ordinance which one is greater (sic).

Please confirm the acceptance of the above by signing of this letter'.

The Appellant confirmed acceptance of these terms by signing on a copy of this letter.

5. On 28 July 2000, Company A and Insurance Company B agreed to terminate the Plan. Between 18 and 23 August 2000, Insurance Company B paid the participating Members their vested benefits. The Appellant received $1,117,836 which included a sum of $443,711. That sum of $443,711 was Company A's contribution in accordance with the provisions of the Plan.

6. On 1 December 2000, the Appellant and Company A entered into a written agreement ['the Written Contract'] whereby Company A agreed to employ the Appellant as director with effect as from 1 December 2000 at a monthly salary of $35,000. Each of Company A and the Appellant is to contribute 5% of the Appellant's basic salary to the Mandatory Provident Fund Scheme up to a maximum of $1,000. In response to the Revenue's enquiries dated 1 April 2003 as to whether there was any change in the Appellant's terms of employment before and after

1 December 2000 other than the change in the rate of contribution by Company A, Company A informed the Revenue by letter dated 15 April 2003 that there was 'change in the rate of contribution and workout proper employment contract'. By letter dated 9 August 2004, the Appellant informed the Revenue that there was no change in his duties before and after 1 December 2000.

7. The issue before us is whether the sum of $443,711 should by virtue of section 8(2)(cc) of the IRO be excluded in computing the income of the Appellant for the purposes of section 8(1) on the ground that it is a sum 'received from the approved trustee of a mandatory provident fund scheme on ... termination of service' or whether the same should be regarded as income under section 9(1)(ab) of the IRO as an amount received by the Appellant under a recognised occupational retirement scheme 'otherwise than because of termination of service'. Both Company A and the Appellant maintain that the same should be excluded. Company A did not include this sum in the Employer's Return of Remuneration and Pensions for the year 2000/01.

Contentions of the Revenue

8. The Revenue's case rests on the decision of this Board in Case No. D101/89, IRBRD, vol 6, 375. That case involved two written contracts. Under the first written contract, the taxpayer was employed as an officer of a local institution on gratuity contract terms. In the course of the first written contract, he was seconded to become a lecturer of an academic department. The second written contract provided for his employment as a lecturer and back-dated his period of probation under the second written contract to the date when he was seconded to become such a lecturer under the first written contract. The taxpayer and his employer each filed a return with the Revenue drawing no distinction between the first and the written contracts. The issue before the Board was whether the leave pay and gratuity which he received should be excluded from the computation of 'rental value' under section 9(2) of the IRO. The taxpayer drew the Board's attention to the existence of two clear and distinct employment contracts. He further pointed out that he held different positions under the two employment contracts. 'The representative for the Commissioner submitted that a distinction must be drawn between a contract of employment and the employment itself. She pointed out that a person can be employed over a period of time under a number of different employment contracts but this does not terminate the employment. She said that it frequently happens that employees have contracts renewed, extended, or modified with different terms and conditions but this does not terminate the employment'. The Board accepted the submission of the Revenue and held that there is a distinction between a contract of employment and the employment itself. On the facts of that case, the Board held that there was no termination of employment. The Board relied on the fact that part of the service under the first written contract was deemed to have been probationary service under the second written contract and the fact that the taxpayer and his employer did not draw any distinction between the two contracts in their returns.

9. Mr Yeung for the Revenue also drew our attention to sections 31B(1), 31D(2), 31R(1) and 31T(2) of the Employment Ordinance (Chapter 57). Those provisions provide in relation to severance payments and long service payments that an employee shall not be taken to be 'dismissed' by his employer if he is re-engaged by the same employer under a new contract of employment and the re-engagement takes effect immediately on the ending of this employment under the previous contract.

Contentions of the Appellant

10. Mr C appeared on behalf of the Appellant. He made repeated references to the notice of termination and the written contract. As a layman, he could not give us any assistance on the arguments advanced by the Revenue.

Our decision

11. Three different concepts are involved: the concept of 'service', the concept of 'employment' and the concept of 'contract of employment'. The IRO does not define any of these concepts.

12. The Oxford English Dictionary defines 'service' to mean 'The condition, station, or occupation of being a servant' or 'A particular employ; the serving of a certain master or household'. On the basis of these definitions, we are content to adopt the tacit approach of this Board in Case No D101/89, IRBRD, vol 6, 375 in equating the concept of service with the concept of employment.

13. We do however entertain reservations in accepting the alleged distinction between a contract of employment and the employment itself. We find the following definitions in the English Employment Rights Act 1996 as summarised in § 2 of Vol 16 Halsbury's Law of England 4th edition of assistance in our analysis:

(a) 'Employer', in relation to an employee or worker, means the person by whom the employee or worker is, or, where the employment has ceased, was, employed.

(b) 'Employee' means an individual who has entered into or works under, or, where the employment has ceased, worked under, a contract of employment.

(c) 'Employment' in relation to an employee, means employment under a contract of employment and, in relation to a worker, means employment under his contract.

(d) 'Contract of employment' means a contract of service of apprenticeship, whether express or implied, and if it is express, whether it is oral or in writing.

14. It is only in exceptional circumstances one finds an employment that is not under a contract of service. As explained by § 542 of Halsbury (above cited), they include employment remunerated out of the revenue of the Duchy of Lancaster or the Duchy of Cornwall and employment remunerated out of the Queen's Civil List. In the context of the labour market in Hong Kong, the contract of employment is the foundation which creates the nexus of employment.

15. Contract of employment is no different from any other contract. The initial contract that establishes the relationship can be rescinded or varied by subsequent mutual agreement. As indicated by § 22-026 of Chitty on Contracts 29th edition Vol 1 'A contract which is rescinded by agreement is completely discharged and cannot be revived'. Variation serves a different function. It is the process of modifying or altering the terms of an existing contract by mutual agreement. The pre-existing contract so altered or modified remains binding between the parties.

16. We are of the view that the true distinction is not between employment and the contract of employment. The true issue is whether the subsequent agreement merely varied the existing agreement or whether it went to the root and rescinded the same. We are of the view that Case No D101/89 is explicable on that basis. The returns filed by the parties in that case coupled with the fact that part of the services previously rendered were expressly retained led the Board to conclude that there was only a variation but not a rescission.

17. The parties in this case clearly intended to bring the contract that subsisted on 12 July 2000 to an end. Three months notice was served for such termination. That contract regulated the employment and service of the Appellant. Termination of that contract brought the employment and the service to an end on 30 November 2000. As a result of that termination the Appellant became entitled to the payment in question in accordance with the terms of the Plan. The returns of the parties and the terms of the 1 December 2000 Written Contract lent no support to the continuance of the previous contract.

18. We are of the view that the provisions in the Employment Ordinance provide no assistance to the Revenue. They deal with the concept of 'dismissal' and the provisions are designed to negate the consequences that flow from the application of the common law in relation to rescission that we outlined above. There is no equivalent provision in the IRO.

19. For these reasons, we allow the Appellant's appeal and set aside the assessment on the sum in question.