Case No. D87/01

Salaries tax – whether a sum was severance payment – a sum paid to the taxpayer on termination of his employment does not necessarily follow that the amount cannot be liable to salaries tax – test for salaries tax liability was whether the sum arose from the employment for services past, present or future – whether ex gratia payment or 'gratuity' – whether arose from the employment – whether being made for past services – an extra emolument paid upon the conclusion of a contract of employment – sections 8(1) and 9(1) of the Inland Revenue Ordinance ('IRO').

Panel: Andrew Halkyard (chairman), Erwin A Hardy and Douglas C Oxley.

Date of hearing: 4 September 2001.
Date of decision: 5 October 2001.

This was an appeal against the salaries tax assessment raised on the taxpayer for the year of assessment 1998/99.

The taxpayer was laid off and was duly compensated.

He contended that a sum ('the sum in dispute') paid to him by his employer as an 'extra one month' payment in addition to all his other entitlements under the employment contract and the Employment Ordinance ('EO') should not be subject to salaries tax.

Held:

1. No part of the sum in dispute was severance pay. Neither was it a contractual payment nor a statutory payment. It was also not a payment for loss of employment rights.

2. In short, the Employer had already fulfilled every contractual and statutory duty in making severance pay to the taxpayer.

3. Further, the Employer agreed that the 'extra one month' payment was a distinct and separate sum from the severance payment.

4. Simply because the amount in dispute was paid to the taxpayer on the occasion of the termination of his employment did not follow that the amount cannot be liable to salaries tax.

5. The test for salaries tax liability was not a 'but for' test; rather, it was whether the sum arose from the employment for services past, present or future: see section 8(1) of the IRO and D2/99 and cases cited therein.

6. The Board agreed with what the Employer said, that it was a payment for something 'extra'. On the facts, the Board found that it could only be categorized as an ex gratia payment or 'gratuity': see section 9(1) of the IRO. It clearly arose from the employment.

7. Furthermore, the Employer acknowledged that the taxpayer's performance in discharging his employment had been 'satisfactory'. The Board was of the view that the sum in dispute would not have been paid if the taxpayer's performance had not been 'satisfactory' and the Board concluded that the payment should be characterized not only as being from the employment but also as being made for past services.

8. The Board appreciated that the Employer acknowledged the amount in dispute was paid to enable the taxpayer to begin looking immediately for alternative employment. But there was no evidence before the Board that this was a personal payment made to relieve hardship. Instead, the circumstances before the Board were much more consistent with the conclusion that the amount was simply an extra emolument paid upon the conclusion of a contract of employment. It followed that all the conditions for liability to salaries tax had been met.

Appeal dismissed.

Case referred to:

D2/99, IRBRD, vol 14, 84

Wong Kuen Fai for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal against the salaries tax assessment raised on the Taxpayer for the year of assessment 1998/99. The basic facts, which are agreed and which we so find, are set out in the Commissioner' s determination dated 29 June 2001.

2. In summary, the facts show:

(a) The Taxpayer accepted an offer of employment from Company A (' the Employer') for the post of area sales manager. The employment commenced on 15 July 1996. The employment letter, signed by both the Employer and the Taxpayer, did not contain any provision concerning termination of employment, nor did it contain any provision relating to notice period and payment in lieu of notice.

(b) By a letter dated 15 January 1999, the Employer terminated the Taxpayer' s employment with immediate effect. The notice stated:

' As you are aware, our regional performance for the last year has not been satisfactory which will result in a decrease in staffing.

I very much regret to inform you that your position as Area Sales Manager, Hong Kong/China will be terminated on January 15. We will be paying you one month' s salary in lieu of notice and another extra one month to enable you to begin looking immediately for alternative employment.

I would like to take this opportunity to say that your performance has been satisfactory, and I shall be pleased to provide any prospective employer with a reference if required.

I do hope you will soon find another suitable position and wish you all the best for the future.'

(c) In addition to the payments described at fact (b) above, the Employer paid the Taxpayer all his other entitlements under the employment contract and the EO. In

an attachment to the letter at fact (b) above, the Employer informed the Taxpayer of the breakdown of the termination payment as follows:

Termination payout:	
(14-1-1999)	$
January salary	41,387.50
Severance payment	37,500.00
Unused leave	60,011.88
One month in lieu of notice	82,775.00
Extra one month	82,775.00
Travel reimbursement	1,000.00
December commission	143,921.63
Total	449,371.01

Issue in dispute

3. The sole issue in dispute in this appeal is whether the amount of $82,775 described at fact (c) in paragraph 2 as ' Extra one month' is chargeable to salaries tax.

The Taxpayer' s contentions

4. In his notice of appeal and arguments before the Board, the Taxpayer contended:

(a) Though the ' Extra one month' payment is not described as severance payment in the Employer' s letter at facts (b) and (c) in paragraph 2, it is very clear that it is part of the severance payment. Had he not been terminated by the Employer, he would not have received this sum of money which was not provided for in his employment contract. Also, it is clearly stated in the letter that the payment facilitated him to look for his next job. So no matter how this sum is presented, its nature is part of the severance payment.

(b) Whether or not he could make a legitimate claim against the Employer to pay more than the EO requires upon termination of employment does not change or effect the nature of the payment. And its real nature is a severance payment. It is a practice in the industry that employers make severance payments more generous than the minimum amount specified in the EO.

(c) The amount in dispute has no relation to the service rendered to the Employer before termination. Had he not been terminated because of lay-off, he would never have received any such payment.

The Commissioner's contentions

5. The representative of the Commissioner, Mr Wong Kuen-fai, contended:

(a) The amount in dispute is not severance pay. A severance payment had already been made to the Taxpayer (fact (c)) and the Taxpayer had received precisely what he was entitled to under his contract of employment and under the EO.

(b) There is no evidence to show that the industry in which the Taxpayer was engaged was more generous in cases of termination of employment. However, if this was indeed the case, the amount in dispute was paid under a trade custom and was thus a normal emolument of the Taxpayer's employment.

(c) The sum in dispute was an ex gratia payment made for past services.

Analysis

6. On the facts found by us, we agree with the Commissioner's representative and conclude that no part of the sum in dispute was severance pay. In short, the Employer had already fulfilled every contractual and statutory duty in making severance pay to the Taxpayer (see fact (c) and section 31G(1) of the EO). Furthermore, the Employer agreed that the 'Extra one month' payment was a distinct and separate sum from the severance payment described at fact (c).

7. We also agree with the Commissioner's representative that, simply because the amount in dispute was paid to the Taxpayer on the occasion of the termination of his employment, it does not follow that the amount cannot be liable to salaries tax. The test for salaries tax liability is not a 'but for' test; rather, it is whether the sum arose **from the employment for services past, present or future** (see section 8(1) of the IRO and D2/99, IRBRD, vol 14, 84 and cases cited therein).

8. What then is the true nature of the amount in dispute? To answer this question, let us first see what it is not – it is not a severance payment, it is not a contractual payment, it is not a statutory payment, and it is not a payment for loss of employment rights. The Employer says that it is a payment for something 'extra'. We agree. On the facts found it can only be categorised as an ex gratia payment or 'gratuity' (see section 9(1) of the IRO). It clearly arises **from the employment**. Furthermore, the Employer acknowledges at fact (c) that the Taxpayer's performance in discharging his employment has been 'satisfactory'. In our view, this sum would not have been paid if the Taxpayer's performance had not been 'satisfactory' and we conclude that the payment should be characterised not only as being from the employment but also as being made **for past services**.

9. We appreciate that the Employer acknowledges the amount was paid to enable the Taxpayer to begin looking immediately for alternative employment. But there is no evidence before us that this was a personal payment made to relieve hardship. Instead, the circumstances before us are much more consistent with the conclusion that the amount was simply an extra emolument paid upon the conclusion of a contract of employment. It follows that all the conditions for liability to salaries tax have been met. The appeal is hereby dismissed.