

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D128/99

Salaries Tax – gains derived from sale of company shares – date of assessment – section 9(1)(d) and section 9(4) of the Inland Revenue Ordinance (‘IRO’), Chapter 112.

Panel: Ronny Wong Fook Hum SC (chairman), Man Mo Leung and Dianthus Tong Lau Mui Sum.

Date of hearing: 27 January 2000.

Date of decision: 24 February 2000.

The taxpayer, by reason of his employment with a number of companies, was entitled to various options in respect of shares of those companies. The taxpayer exercised his right to subscribe for shares in those companies on various dates.

The taxpayer asserted that his tax liability should be confined to his actual gain because as a director of those companies, he was prevented by the Listing Rules from selling the shares in August 1997 when the shares were quoted at high levels in the Hong Kong Stock Exchange.

The Commissioner maintains that on a proper construction of section 9(1)(d) and section 9(4)(a) of the IRO, the relevant date is the date of the exercise of the options.

Held :

All the cases before the Board are unanimous in concluding that section 9(4)(a) of the IRO seeks to tax a notional gain assessed in the way defined by that subsection. It is not referring to the actual gain. The actual gain can be much more, much less, it can even be a loss. As the assessment is based on a notional gain, the fact that the taxpayer did not in fact realise such gain because of circumstances beyond his control is not a relevant consideration. There is no equity in a taxing statute (D43/99 applied).

Appeal dismissed.

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Cases referred to:

D14/90, IRBRD, vol 5, 131
D4/91, IRBRD, vol 5, 542
D66/94, IRBRD, vol 9, 373
D43/99, IRBRD, vol 14, 448

Ma Wai Fong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Background

1. At the material times, the Taxpayer was a director of Company A, Company B and Company C. He left Company A and Company B on 23 October 1997. He parted with Company C on 13 November 1997.
2. Company B and Company C are listed companies. By virtue of his employment with these companies, the Taxpayer became entitled to various options in respect of shares of both companies. The Taxpayer exercised his right to subscribe for shares in both companies in circumstances as follows:

	Company B shares	Company C shares	Company C shares
Date of exercise	28-7-1997	28-7-1997	31-10-1997
No of shares subscribed	710,000	600,000	200,000
Subscription price	\$1.01 per share	\$0.8 per share	\$0.8 per share
Date when the board of directors approved the allotment of shares	28-7-1997	28-7-1997	31-10-1997
Date of issue of share certificate	1-8-1997	28-7-1997	31-10-1997
Closing price of the share on the date of exercise	\$1.17	\$1.79	\$1.6
Highest price of the share on date of exercise	\$1.2	\$1.86	\$1.63

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Lowest price of the share on date of exercise	\$1.17	\$1.77	\$1.43
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3. The Taxpayer disposed of his Company B and Company C shares on dates and at price set out hereunder:

Name of share	Date of sale	Quantity sold	Selling price per share \$	Amount realized \$	
Company C	17-10-1997	190,000	1.4	266,000	
	17-10-1997	210,000	1.39	291,900	
	22-10-1997	100,000	1.38	138,000	
	27-10-1997	100,000	1.23	123,000	
	14-11-1997	10,000	1.56	15,600	
	14-11-1997	190,000	1.55	294,500	
					1,129,000[A]
Company B	20-1-1998	110,000	0.6	66,000	
	21-1-1998	20,000	0.59	11,800	
	22-1-1998	220,000	0.59	129,800	
	22-1-1998	40,000	0.52	20,800	
	22-1-1998	40,000	0.51	20,400	
	22-1-1998	200,000	0.5	100,000	
	22-1-1998	80,000	0.57	45,600	
					394,400[B]
			[A] + [B]	1,523,400	

4. The Taxpayer asserted that his tax liability should be confined to his actual gain of \$138,300 arrived at as follows:

Company	Shares	Subscription	Sale price	Profit/loss
Company B	710,000	\$1.01/share in August 1997	\$0.54/share in January 1998	(\$333,700)
Company C	800,000	\$0.8/share in August 1997	\$1.39/share in October 1997	\$472,000
Net gain on income				\$138,300

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The Taxpayer explained that as a director of the two companies, he was prevented by the Listing Rules from selling the shares in August 1997 when the shares were quoted at high levels in the Hong Kong Stock Exchange.

5. The Revenue pointed out that on the basis of the existing authorities, there are 3 possible dates for assessment of the Taxpayer's liability:

Share		Date of exercise of options		Date when relevant certificates issued		Date when relevant certificates obtained	
Company	Total No	Unit price \$	Total proceeds \$	Unit Price \$	Total proceeds \$	Unit price \$	Total proceeds \$
Company B	710,000	1.17 - 1.01	113,600	1.4 - 1.01	276,900	2,225 - 1.01	862,650
Company C	600,000	1.79 - 0.8	594,000	1.79 - 0.8	594,000	1.62 - 0.8	492,000
Company C	200,000	1.6 - 0.8	160,000	1.6 - 0.8	160,000	1.59 - 0.8	158,000
			867,600		1,030,900		1,512,650

The Revenue maintains that on a proper construction of section 9(1)(d) and section 9(4)(a) of the Inland Revenue Ordinance (the IRO), the relevant date is the date of exercise of the options. On the facts of this case, that date is the most beneficial of the 3 dates vis-a-vis the Taxpayer.

Hearing before us

6. The Taxpayer reckoned that he should be afforded sympathetic treatment by the Revenue given his constraints under the Listing Rules. He argued that the Listing Rules and the IRO are both regulations emanating from the Government and Revenue should not ignore the Listing Rules when applying the relevant provisions of the Inland Revenue Ordinance.

7. The Taxpayer made no attempt to understand or analyse the tax position as explained in the 4 authorities [D14/90, IRBRD, vol 5, 131; D4/91, IRBRD, vol 5, 542; D66/94, IRBRD, vol 9, 373 and D43/99, IRBRD, vol 14, 448] the Revenue cited before this Board.

The relevant statutory provisions

8. Section 9(1)(d) of the IRO provides:

'Income from any office or employment includes:

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(d) *any gain realised by the exercise of, ... a right to acquire shares or stock in a corporation obtained by a person as the holder of an office in or an employee of that or any other corporation.'*

9. Section 9(4) of the IRO provides:

'For the purposes of subsection (1):

(a) *the gain realised by the exercise at any time of such a right as is referred to in paragraph (d) of the subsection shall be taken to be the difference between the amount which a person might reasonably expect to obtain from a sale in the open market at that time of the shares or stock acquired and the amount or value of the consideration given whether for them or for the grant of the right or for both.'*

Our decision

10. All the cases before this Board are unanimous in concluding that section 9(4)(a) of the IRO seeks to tax a notional gain assessed in the way defined by that subsection. As pointed out by this Board in D43/99, 'It is not referring to the actual gain. The actual gain can be much more, much less, it can even be a loss.' As the assessment is based on a notional gain, the fact that the Taxpayer did not in fact realise such gain because of circumstances beyond his control is not a relevant consideration.

11. We are of the view that the present predicament of the Taxpayer stems from his failure to properly consider his tax position prior to his exercise of the various options. There is no equity in a taxing statute. His complaints against the Revenue for lack of sympathetic treatment is totally misconceived.

12. For these reasons, we dismiss the Taxpayer's appeal.