Salaries Tax Tips

Andrew Halkyard offers a number of strategic tips to employers and employees when it comes to assessing salaries tax.

‘Holidaying’ Employees
Many employers who provide holiday allowances for their staff are aware of the generous exemption provided in s 9(1)(a) of the Inland Revenue Ordinance (Cap 112) (IRO). It may not, however, be generally appreciated that in practice the scope of the exemption is particularly wide.
Specifically, it is understood that the Inland Revenue Department (IRD) allows at least the following expenses to qualify for exemption: travel costs (including car hire), local sightseeing tour costs, airport taxes, excess baggage costs, hotel accommodation costs and package tours. It is also understood that holiday allowances covering a taxpayer’s spouse and children are accepted as falling within the exemption provided by s 9(1)(a).

For Owner/Occupier
The question has arisen concerning the IRD’s assessing policy where the employer leases premises owned by its employee (or a relative) for use as the employee’s quarter. In this case it is understood that the Commissioner accepts in principle that a taxpayer can wear both the hat of an employee and a landlord at the same time and that if the arrangement is a genuine, arm’s length and reasonable one, it will not be challenged.

The Commissioner will take into account factors such as whether there is a duly stamped lease, whether the rent is at market value, whether the rental income is reported by the employee as liable to property tax, whether the rent paid is reasonable in relation to the overall employment package, and whether the housing benefit is provided for in the contract of employment. If the employer and employee are related the Commissioner may closely monitor the arrangement. (Source: minutes of meetings between representatives of the IRD and the Taxation Institute of Hong Kong on 24 January 1997 and the Hong Kong Society of Accountants on 17 January 1997)
In order for there to be any refund of rent, there must exist a legal relationship of landlord and tenant with the employee or office holder as tenant. This hurdle could not be overcome in D33/97 12 IRBRD 228, (1997) HKRC §80-523, where the taxpayer entered into a non-binding family or social arrangement with his parents (the owners of the relevant property) to take advantage of a housing benefit scheme offered to the taxpayer by his employer. In this case the Board stated that it was not enough for the taxpayer simply to rely upon the formal niceties of paying cheques to his parents, issuing receipts and completing property tax returns. In the event, the amount in dispute could not in law be classified as a ‘refund of rent’.

Employees Receiving Stock Options
Sections 9(1)(d), 9(4) and 9(5) of the IRO govern the taxation of stock options. In short, the taxable event crystallises not when the option is exercised or disposed of. In most cases, these statutory rules are easy to apply. However, when applied to the so-called cross-border employee, their applicability has generated both comment and controversy.
According to an article published by the IRD in The Hong Kong Accountant (Sept/Oct 1997), the Department’s position is that the taxation of gains from share option schemes is determined by whether the employee was employed in Hong Kong at the time the option was granted. This is regardless of where the employee worked during the following times: the vesting period, the additional holding period (if relevant) and at the date of the grant.
Although this is a clear and easily applied rule, it does create practical difficulties in terms of (1) the employer’s reporting obligation where the employee has left Hong Kong prior to the exercise of the option; and (2) the Department’s ability to collect tax from a person who has left Hong Kong permanently.

Since the IRD’s article was published, it is understood that there has been a tendency on the Department’s part to resolve the taxation of stock options for travelling employees by applying an apportionment formula. The formula seeks to bring to charge to salaries tax a portion of the gain realised from the exercise of a share option in accordance with a ratio which has the following elements:
• a numerator, which represents the period during which the employee was based in Hong Kong during the option period;
• a denominator, which represents the entire option period; and
• a further ratio, which takes into account the entitlement of the employee to days in/days out apportionment assessment (where applicable).

It is not clear at the time of writing whether this latter ratio is measured with respect to the year of exercise only or with respect to the total period of the employee’s employment in Hong Kong during the holding period.
In light of these assessing practices, and the publicity (or lack thereof) accorded to them, it would not come as any surprise if the IRD were to seek either an amendment to the law or, as seems more likely, publish a Departmental Interpretation and Practice Note clearly setting out how an employee receiving stock options will be assessed.

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Postscript

The payment in lieu of notice case, EMI Group Electronics Ltd v Coldicott [1997] STC 1372, referred to in the March 1999 issue of Hong Kong Lawyer, is final (see Simons Tax Intelligence 1998). Apparently, leave to appeal to the House of Lords was refused and the judgment of Neuberger J will stand.

The appeal to the Court of First Instance in D 75/96 12 IRBRD 19, [1997] HKCR 880-491 concerning the application in Hong Kong of Sharkey v Wernher, referred to in the May 1999 issue of Hong Kong Lawyer, has been decided in favour of the taxpayer: see CIR v Quitsubdue Ltd (HCIA No 5/98) (30 April 1999). It is not yet known whether the Commissioner will lodge a further appeal to the Court of Appeal.

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