



Inland Revenue Department
Hong Kong

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

NO. 16 (REVISED)

SALARIES TAX

TAXATION OF FRINGE BENEFITS

These notes are issued for the information and guidance of taxpayers and their authorised representatives. They have no binding force and do not affect a person's right of objection or appeal to the Commissioner, the Board of Review or the Courts.

These notes replace those issued on 29 January 1991.

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Commissioner of Inland Revenue

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INTRODUCTION

Following the enactment of the Inland Revenue (Amendment) Ordinance 1991 (“the 1991 Amendment”), it is considered necessary to explain why the Ordinance has been amended and lay down broad statements on the practice to be adopted by the Inland Revenue Department in relation to the taxation of fringe benefits received by employees and office holders. In the latter regard, this Practice Note is concerned with fringe benefits other than direct monetary payments to employees and benefits in respect of accommodation and gains from shares and stock.

BACKGROUND TO THE 1991 AMENDMENT

2. The case of *David Hardy Glynn v The Commissioner of Inland Revenue* 3 HKTC 245 had significant implications in relation to the taxation of fringe benefits and ultimately led to the introduction of the 1991 Amendment under consideration. Before turning to the significance of the decision, it is relevant to outline the assessing practice followed by the Department in respect of fringe benefits before the case arose.

Pre-Glynn Assessing Practice

3. Section 8(1) of the Ordinance lays the charge to Salaries Tax on “every person in respect of his income arising in or derived from Hong Kong” from any office or employment of profit and any pension. There is no exhaustive definition of “income from any office or employment”. However, some of the more common kinds of income are enumerated in section 9(1) and the word “perquisite”, albeit undefined, has been included since the introduction of the Ordinance.

4. Prior to the *Glynn* case, it was accepted by the Department and practitioners generally that principles derived from UK case law determined whether perquisites, or fringe benefits, were taxable. The Department’s assessing practice was based on the understanding that UK decisions had established that benefits received in a form other than money, unless covered by specific provisions in the Ordinance, could only be treated as chargeable income if they took the form of “money’s worth”. A benefit was regarded as

constituting money's worth if it was capable of being converted into money (by sale or some other means) by the recipient or involved the discharge of a personal liability of the employee. On the other hand, if the Department recognized that the employee was not liable for the relevant expense and the benefit was inconvertible, it was generally accepted that the benefit was not chargeable.

5. With regard to education benefits, however, the Department consistently took the view that any payment made by an employer in respect of education expenses of an employee's child represented a chargeable benefit to the employee. This position was based on the understanding that it was not possible for an employee as a parent to transfer the liability for the education of his children to a third party. Any payment made by the employer was treated as discharging the employee's liability and accordingly regarded as "money's worth".

The Glynn Case – the Court of Appeal decision

6. In the *Glynn* case, school fees in respect of Mr. Glynn's daughter were paid direct to the school by his employer. The issue, in broad terms, was whether the payments constituted chargeable income of Mr. Glynn or escaped chargeability by virtue of the arrangements used to make the payments.

7. The majority of the Court of Appeal held that the payments in question had been correctly treated by the Department as being chargeable to Salaries Tax. The decision (reported in 2 HKTC 383) was significant in at least two respects. Firstly, because all three members of the Court agreed that it had wrongly been assumed that UK authorities were directly relevant and applicable in Hong Kong and, secondly, because a majority found that the word "perquisite" in the Ordinance should be given its wide ordinary meaning. A strict application of the decision would have required the taxation of all benefits derived by an employee from his employment.

The Administration's response to the Court of Appeal decision

8. In view of the implications of the decision, particularly in relation to the identification and valuation of benefits, the Administration decided that the Ordinance should be amended to accord with the practice followed by the

Department before the *Glynn* case arose. This decision was announced by the Department in a public statement issued in March 1989. It was also announced that the Department would continue to apply its pre-Glynn practice pending the introduction of the legislation. Shortly afterwards, drafting work commenced on the proposed legislation but finalization was held in abeyance pending the outcome of Mr. Glynn's appeal to the Privy Council.

Outcome of the Privy Council Appeal

9. In contrast to the Court of Appeal's decision, the Privy Council held that UK authorities on the meaning of expressions in UK tax legislation are of assistance in construing identical expressions in the Ordinance concerning the same subject matter. It was also held that "perquisite" has the same meaning in the Ordinance as it has in the UK legislation.

10. The decision (reported in 3 *HKTC* 245) reflected the Department's pre-Glynn understanding of what constituted a chargeable perquisite to the extent that it recognized that the term includes:

- (a) money which can be obtained from property which is capable of being converted into money; and
- (b) money which is paid in discharge of a debt of the employee.

However, the Judicial Committee went further when it held that there is no difference between a debt of the taxpayer discharged by an employer pursuant to the contract of service and money paid for the benefit of an employee by his employer pursuant to the contract of service. The Privy Council was of the view that money paid at the request of an employee is equivalent to money paid to the employee. In this regard it was stated that an identifiable sum required to be expended by an employer pursuant to a contract of service for the benefit of the employee, is money paid at the request of the employee and is taxable as either part of the employee's salary or as a monetary perquisite.

11. The decision did not, however, encompass all benefits derived by an employee from his employment. Inconvertible benefits not involving the expenditure of money or expenditure not attributable wholly or proportionately to one employee were recognized as not being chargeable¹. As an example,

the Privy Council mentioned a nursery school provided by an employer for the children of all its employees. It also accepted that benefits resulting from expenditure by an employer for a non-contractual reason – for example on compassionate grounds – escaped chargeability if lacking the elements of expectation and continuity. The Privy Council’s position concerning such benefits reflected the Department’s pre-Glynn practice.

12. On the other hand, the decision represented a departure from the Department’s pre-Glynn practice in that it was not consistent with the view that an inconvertible benefit escaped chargeability to Salaries Tax if the employer rather than the employee was the party liable for the payment of the relevant expense.

13. As the Privy Council’s decision in the *Glynn* case confirmed that not all employment benefits come within the charge to Salaries Tax, it mitigated to a certain extent the effects of the Court of Appeals decision. Nevertheless, the decision, and in particular its effective rejection of the “liability test” as a determinant of chargeability, made it clear that the scope of the then legislation was wider than the Department had understood it to be pre-Glynn.

DETAILS OF THE 1991 AMENDMENT

14. As foreshadowed in the announcement after the Court of Appeal decision, the Ordinance was amended to accord with the Department’s pre-Glynn assessing practice in respect of fringe benefits. A “liability test”, contained in subparagraph (iv) to section 9(1)(a), was introduced to exclude from chargeability any benefit where the relevant payment is one for which the employer has the sole liability. The exclusion does not apply to any payment made by an employer to discharge a liability of an employee and, as previously, such a payment would normally be chargeable to Salaries Tax as a perquisite.

15. The exclusion provided by section 9(1)(a)(iv) is subject to section 9(2A)², which ensures that convertible benefits and education benefits remain chargeable to Salaries Tax, even if it can be argued that the employer has the liability for the relevant payment.

16. Two definitions were added to section 9(6)³ of the Ordinance. A definition of “child of an employee”, along the lines used in Part V of the Ordinance, has been inserted for the purposes of the provision concerning the taxation of education benefits. The second definition is of “employee” and this has been defined to include a holder of an office. This latter definition has been included to make it clear that the exclusion of benefits from chargeable income by section 9(1)(a)(iv) applies to an employee and an office holder. Further, the definition ensures that accommodation benefits provided to office holders are chargeable to the same extent as those provided to employees.

17. Section 8(2)(g) of the Ordinance has been amended to confirm that the exemption from Salaries Tax in respect of amounts arising from educational endowments applies only for the benefit of the person receiving the relevant education. This is to preclude any argument that an education benefit, provided by an employer in respect of a child of an employee, is not chargeable income of the employee by virtue of section 8(2)(g).

TREATMENT OF PARTICULAR BENEFITS

18. Set out below are details of how the Department views the taxation position of various categories of non-cash fringe benefits derived by employees and office holders from their employers or others. As the particular arrangements under which fringe benefits are provided can have a bearing on the taxation consequences, the examples provided are in broad terms only. It must be stressed that whilst the Department recognizes and accepts that employment packages may legitimately be structured in a variety of ways, action will be taken in respect of blatant or contrived tax avoidance arrangements. In the latter regard, it is relevant that section 61A of the Ordinance provides that, in broad terms, where it is concluded that a transaction has been entered into for the sole or dominant purpose of obtaining a tax benefit, an assessment may be made in a manner appropriate to counter the tax benefit. Furthermore, section 61 of the Ordinance provides for artificial or fictitious transactions and dispositions to be disregarded. However, in relation to the examples below it has been assumed that the benefits are provided under circumstances which would not warrant the application of the anti-avoidance provisions.

Liability of Employee discharged by Employer

19. The Privy Council confirmed in the *Glynn* case that perquisite includes money which is paid in discharge of a debt of the employee. This position has not been affected by the 1991 Amendment discussed above. Accordingly, where such a payment is made by an employer, the amount of the payment is regarded by the Department as chargeable income of the employee.

Convertible Benefits

20. The Privy Council also confirmed that perquisite includes money which can be obtained from property which is capable of being converted into money. The introduction of the “liability test” in section 9(1)(a)(iv) has not affected the position. Section 9(2A)² provides that the test shall not operate to exclude from income “any benefit capable of being converted into money by the recipient”⁴.

21. Where a benefit takes the form of an asset which can be converted into money by sale, the Department’s basic approach will be to take as the amount assessable the sum which the asset might reasonably be expected to fetch if sold in the open market at the time of receipt of the benefit; i.e. the “second-hand” value⁵.

22. Benefits⁶ which are not convertible into money by sale are sometimes convertible by other means. For example, an employee might be provided by his employer with the free use (but not ownership) of a car under an arrangement which would allow the employee to “surrender” the car and take additional wages instead. Such a benefit would be viewed by the Department as being convertible into money and accordingly chargeable (see *Heaton v Bell* 46 TC 211). It is not possible to lay down hard and fast valuation rules to cover benefits which come within this category. The approach taken will depend on the nature of the benefit and the circumstances under which it is provided. In general terms, however, the aim will be to ascertain, as objectively as possible, the amount of money the employee could obtain if he chose to “convert” the benefit. For the example given, the Department would treat as assessable income each year the amount of additional wages the employee would have received if he had chosen to forego the benefit.

Education Benefits

23. Amounts “paid by an employer in connection with the education of a child of an employee” are by virtue of section 9(2A) not subject to the “liability test” in section 9(1)(a)(iv). Accordingly, where such a payment is made pursuant to the employee’s contract of employment, then irrespective of whether the employee or the employer is the party liable for the relevant expense, the amount paid will be treated as chargeable income of the employee.

24. The Department will interpret the expression “paid by an employer in connection with the education of a child” as covering not only payments for tuition expenses, but also payments for incidental education expenses such as boarding fees and the cost of school outings. Amounts paid before 1 April 2003 in respect of passages in connection with education are not chargeable by virtue of the terms of sections 9(1)(a)(i) and (ii) of the Ordinance. However, with the repeal of sections 9(1)(a)(i) and (ii) by Revenue (No. 2) Ordinance 2003, these payments will be chargeable with effect from 1 April 2003.

25. In accordance with the decision in an English case, *Barclays Bank v Naylor 39 TC 256*, the Department recognizes that an employee does not receive a chargeable benefit where a payment is made in respect of education expenses of his or her child using income of the child which has been provided by a genuine discretionary trust funded by the employer.

Car (or Boat) made available by an Employer for the Private Use of an Employee

26. Where an employee is allowed to use for private purposes a car owned by his employer, the Department accepts that the benefit is not chargeable, provided that the employee is not in any way able to convert the benefit into money [compare the position outlined at para. 22 above].

27. If ownership of the car is transferred to the employee, the benefit is chargeable to Salaries Tax at its convertible value at the time of receipt [see para. 21 above].

28. A chargeable benefit will also arise if the employer discharges an expense relating to private use for which the employee is liable. The assessable

amount will be the sum paid by the employer to discharge the expense [see para. 19 above].

Recreational Facilities/Holiday Homes provides for the Use of Employees

29. Such benefits are not chargeable to Salaries Tax, provided that the employee is not in any way able to convert the benefit into money.

Payment of Utilities by the Employer

30. Where an employer is the only party liable to pay the cost of utilities provided to an employee's residence, payments made by the employer come within the scope of the new exclusion from income [section 9(1)(a)(iv)]. Since utilities provided cannot be converted by the employee into money, the exception to the exclusion in respect of convertible benefits [section 9(2A)(a)] does not apply. As a matter of practice, if the account rendered by the utility company is in the name of the employer only, the Department will accept that no chargeable benefit arises.

31. Other benefits supplied in respect of an employee's residence – such as furniture and domestic servants – will also not be chargeable to tax if they are provided under circumstances where the employer is the only party liable for the relevant expense and the employee cannot convert the benefit into money.

Loans provided to Employees at less than Market Interest Rates

32. The Department accepts that interest-free and low interest loans provided by employers to employees are not chargeable benefits where the cost involved in providing the benefit is the sole liability of the employer. This acceptance is based on the understanding that the benefit received by the employee (i.e. paying less than market rates) is not of itself convertible into money.

Credit Cards

33. Credit cards are sometimes provided by employers to employees under arrangements where expenses charged using the card are billed to and

paid for the employer. Where such a card is used for private purposes by an employee, the Department considers that the benefit obtained is chargeable to Salaries Tax. This is because in ordinary usage the holder of the card (i.e. the employee) has a liability to pay for the goods or services received which is effectively discharged by the employer when the card is used. As discussed in para. 19 above, the amount of the liability so discharged represents a chargeable benefit.

Club Benefits

34. It is accepted that no chargeable benefit arises in respect of the cost of acquisition of corporate membership of a club. The Department recognizes that as entitlement to corporate membership benefits may be transferred from one employee to another it is not possible to attribute such expenditure to a particular employee. On the other hand, where an employer makes a payment in respect of an individual membership fee or other club expense for which an employee is personally liable, the payment will constitute chargeable income of the employee.

Holiday Journey Benefits

35. Prior to 1 April 2003, the value of any holiday warrant or passage granted by an employer to an employee was exempt from salaries tax, as long as the benefit had been used for travel. Similarly, allowance for the purchase of holiday warrant or passage and allowance for the transportation of the employee's personal effects in connection with the holiday warrant or passage were exempt, in so far as they had been used for the purpose. Following the enactment of Revenue (No. 2) Ordinance 2003 which came into effect on 1 April 2003, the exemption from tax of such benefits has been removed.

36. In addition, section 9(2A) was amended to the effect that all payments by an employer in connection with a holiday journey for the benefit of the employee, irrespective of whether it is convertible into cash and whether the primary liability for the benefit is the employee's own, the actual amounts paid by the employer will be assessable to tax with effect from 1 April 2003. For details, please refer to Departmental Interpretation & Practice Notes No. 41.

- Note 1. In contrast, a different approach is adopted by the Department on holiday journey benefits accruing from 1 April 2003, see Departmental Interpretation & Practice Notes No. 41, para. 18.*
- 2. Section 9(2A) was further amended by Revenue (No. 2) Ordinance 2003 to provide for the taxation of holiday journey benefits with effect from 1 April 2003.*
 - 3. The definition of “holiday journey” was further added by Revenue (No. 2) Ordinance 2003.*
 - 4. The relevant phrase was changed to “any benefit that is capable of being converted into money by the recipient” by the Revenue (No. 2) Ordinance 2003.*
 - 5. This approach is not applicable to holiday journey benefits accruing from 1 April 2003. For details, see Departmental Interpretation & Practice Notes No. 41.*
 - 6. Holiday journey benefits accruing from 1 April 2003 are excluded. For taxation of holiday journey benefits, see Departmental Interpretation & Practice Notes No. 41.*