



# Hong Kong Tax Alert

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## Salaries Tax – Taxation of Share Awards (Vesting vs. Forfeiture)

### Summary

On 22 July 2022, the Court of Appeal (“CA”) handed down its decision on the case of *Richard Paul Mark Aidan Forlee v Commissioner of Inland Revenue [2022] HKCA 1098* dismissing the Commissioner’s appeal and up-holding the Court of First Instance’s decision in favor of the Taxpayer, Mr Forlee.

This decision confirms the flexibility available to employers to influence the timing of tax on share benefits when properly designed and implemented.

The CA concluded that the income in respect of shares granted to the taxpayer accrued to him at the time that the shares were awarded, even though the shares were still subject to forfeiture. The CA also concluded that dividends received from the shares are non-taxable because they were income from the shares, not from employment.

This decision clarifies the principles to determine when income in respect of share awards accrues and should be taxed and reaffirms the distinction between an outright grant of shares which are forfeitable, and a conditional award of shares subject to vesting conditions.

Employers should consider the taxation principles set out in this decision when designing a new incentive plan or reviewing the tax position of an existing incentive plan. The terms of the awards may impact the timing of when a taxable benefit arises.

The CA also concluded that the shares were not income from the Taxpayer’s Hong Kong employment as they were awarded in relation to performance while employed in the UK.

As of the date that this alert is published, it is unclear whether the Inland Revenue Department will appeal against the CA’s decision. KPMG will continue to monitor the status of this case and provide an update in due course. The background of Mr Forlee’s employment, the Shares awarded to him, the Board of Review’s decision, and the Court of First Instance’s (“CFI”) decision can be found in our previous [tax alert on the CFI’s decision on this case](#) issued last year.



### Why this matters

The CA's decision confirms the distinction between:

- shares awarded by an employer that are subject to vesting conditions to be met before an employee becomes the legal or beneficial owner of the shares; and
- conditions that may cause a later forfeiture of shares which are transferred to an employee (or to a nominee for his/her benefit) upon award.

The point of accrual and, therefore, the taxing point may differ depending on the terms, i.e., defer taxation until vesting or bring forward taxation at the time of award.

Employers with existing schemes should review their current share plan terms to ensure that the outcomes remain as previously expected.

The decision gives flexibility to employers when establishing a share plan. Through the proper design and implementation of a share plan, an employer can choose whether employees will trigger tax earlier (possibly, when the value is lower) or later (possibly at a higher value but when the benefit is more liquid).

Employers should ensure that the outcomes are planned and do not arise by accident, as there could be a significant difference in the outcome for employees and the attractiveness of the awards. Early-stage companies seeking to minimize cash burn but to attract and retain key talent should pay particular attention to this.

The distinction between vesting and forfeiture drawn by the Hong Kong courts is different from the tax position in some other jurisdictions, which may consider the employment income to arise only after the risk of forfeiture has ended.

KPMG People Services has a team specializing in the design and implementation of equity remuneration arrangements and can help you review or design your share plans to best achieve your compensation objectives. Please contact Murray Sarelius, Gabriel Ho or your usual KPMG contact.

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