

# Hong Kong (SAR) Tax Alert

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## Salaries Tax – Compensation for loss of rest days and statutory holiday days



### Summary

On 22 February 2023, the Court of Appeal (“CA”) handed down its decision on the case of *Dr. Leung Ka-Lau v Commissioner of Inland Revenue*<sup>1</sup>. The CA dismissed the Commissioner’s appeal and upheld that an award of damages granted to the taxpayer for his loss of rest days and statutory holidays was not income from employment and thus not assessable to Hong Kong Salaries Tax.

### Background

- The taxpayer, Dr. Leung, was one of the lead plaintiffs in an action brought by 165 doctors employed by the Hospital Authority (“HA”) against the HA. The dispute pertained to the excessive working hours and denial of rest days to the doctors.
- By the Court of Final Appeal’s judgment (“CFA judgment”) on 20 October 2009<sup>2</sup>, it was held that the doctors are entitled to rest days, statutory and public holidays and in default of being granted such rest days and holidays, they are entitled to damages to be assessed in an amount equivalent to a full day’s wages in respect of each missed rest day or holiday, in accordance with section 17 of the Employment Ordinance.
- The taxpayer was awarded a sum of HK\$1,765,821 pursuant to the CFA judgment as compensation for his loss of rest days and statutory holidays from 17 March 1996 to 1 October 2005 (the “Sum”).
- The Inland Revenue Department (“IRD”) took the view that the Sum should be chargeable to Hong Kong Salaries Tax under section 8 of the Inland Revenue Ordinance (“IRO”) and raised the salaries tax assessment for the year of assessment 2012/13. The assessment was then affirmed by the determination of the Deputy Commissioner of the Inland Revenue dated 5 December 2018.
- The taxpayer lodged the objection, but the Board of Review upheld the IRD’s position in a decision dated 24 June 2020.
- The taxpayer appealed to the Court of First Instance (“CFI”), which subsequently overturned the Board’s decision. It was ruled that the Sum was a compensatory payment from the deprivation of the taxpayer’s rest day, instead of a payment for his work and hence, should not fall within the charging scope of the Salaries Tax<sup>3</sup>.
- The present case is the Commissioner’s appeal to the CA.

<sup>1</sup> The CA judgment can be accessed via this [link](#) to the Judiciary website.

<sup>2</sup> The CFA judgment can be accessed via this [link](#) to the Judiciary website.

<sup>3</sup> The CFI judgment can be accessed via this [link](#) to the Judiciary website.

### The Decision

The CA dismissed the Commissioner's appeal by a majority (2 to 1, with one judge dissenting) holding that the Sum was not income from employment and not taxable. The CA upheld the CFI judgment and concluded that the Sum could not be regarded as "income from employment" in considering:

- (i) The distinction between a payment made pursuant to the contract of employment and a payment made as consideration for abrogating rights under the contract:
  - The Sum was not provided for in the employment contract.
  - Regarding the statutory holidays, there is statutory prohibition<sup>4</sup> for paying the employees in lieu of working on the statutory holidays.
  - Regarding the rest days, there was no request and consent, and no agreement between the taxpayer and the HA for giving up his rest days and being on-call while away from the hospital.
  - It was held by the courts that there was the deprivation of the taxpayer's right to absence from work on rest days and public holidays, and the Sum received was consideration for such deprivation.
- (ii) The Sum could not be regarded as a reward for provision of services in the past or a payment made in respect of the taxpayer's employment.
- (iii) The taxpayer has paid tax on the salary earned for the rest day and should not have to pay tax again on the compensation received for the deprivation of his rest day.

### KPMG Observations

While the key principles to determine taxability were agreed upon, the judges' split decision highlights that their application are not straight forward. Application of these principles will continue to be a contentious matter and are often applied to determine the taxation of termination payments.

<sup>4</sup> Section 40A(1) of the Employment Ordinance states that no payment of holiday pay shall be made in lieu of the grant of a holiday.

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