



GMS Flash Alert

Global Compensation Edition

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Hong Kong - Salaries Tax Treatment of Share Award, Vesting vs. Forfeiture

On 22 July 2022, Hong Kong's Court of Appeal issued an important decision on equity-based compensation that, dismissed the Commissioner's appeal and upheld the lower court's decision in favor of the taxpayer.¹

The Court of Appeal held that income in respect of shares granted to the taxpayer-employee accrued to him at the time that the shares were awarded, even though the shares were still subject to forfeiture. The court concluded that the shares were not income from the taxpayer's Hong Kong employment because they were awarded in relation to performance by the taxpayer while employed in the UK. The court also concluded that dividends received from the shares are non-taxable because they were income from the shares, not from employment. For prior coverage of the case, see [GMS Flash Alert 2021-244](#) (24 September 2021).

WHY THIS MATTERS

The decision illustrates the flexibility and importance of a properly designed equity-based compensation plan, where it may impact the timing of taxation for employees. An employer should consider the taxation principles set out in this decision and its implication, i.e., whether employees may trigger tax earlier (possibly, when the value is lower) or later (possibly at a higher value but when the benefit is more liquid).

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

Details

The Court of Appeal'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 that 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).

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

KPMG NOTE

The decision affirms certain levels of flexibility available to employers to influence the timing of tax on share benefits when the plan properly designed and implemented. Employers, therefore, need to consider the taxation principles set out in this decision when designing a new incentive plan and to review the tax position of an existing incentive plan. The terms of the awards may affect the timing of when a taxable benefit arises.

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.

Lastly, it is not known whether the Inland Revenue Department will appeal.

FOOTNOTE:

1 *Richard Paul Mark Aidan Forlee v Commissioner of Inland Revenue [2022] HKCA 1098.*

RELATED RESOURCE:

This article is adapted, with permission, from “Salaries Tax – Taxation of Share Awards (Vesting vs. Forfeiture)” in *Hong Kong Tax Alert* (August 2022, Issue 13), a publication of the KPMG International member firm in Hong Kong.

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