



ST. GEORGE'S BUILDING

Is Termination Payment Taxable in Hong Kong?

The rule of thumb in determining whether a termination payment received by an employee is taxable or not is:-

- Whether the payment arises from an office or employment; and
- Whether the payment is made in consideration of services rendered in the past, present or future.

The treatment, however, differs according to the nature of termination payments

1. Payment in lieu of notice

Prior to the year of assessment 2012/13, it was the Inland Revenue Department's ("IRD") practice to treat payment in lieu of notice made in accordance with the terms of the employment contract or the provisions of the Hong Kong Employment Ordinance ("EO") as non-taxable.

However, such tax treatment was no longer adopted as a result of a Court of Final Appeal case in 2011 which held that payment in lieu of notice contractually agreed by the employer and the employee should be income arising from employment and hence chargeable to salaries tax.

It follows that from year of assessment 2012/13 onwards, payment in lieu of notice accrued to employees on or after 1 April 2012, whether paid under an express or an implied contract term, will be assessable to salaries tax.

2. Payment in lieu of leave

Cash payment in lieu of leave accrued at termination of employment is similar to salary received by an employee during sick leave, and is thus taxable.

3. Severance payments / long service payments

Under the EO, an employee who satisfies the prescribed conditions and a qualifying period of employment is eligible for severance payment or long service payment. Both are calculated based on the years of service at a rate of 2/3 of monthly salary or 2/3 of HK\$22,500, whichever is lower. The IRD considers that those statutory payments provided by the EO are not payments made for services rendered but payments made to terminate the

employment. They therefore fall outside the scope of salaries tax.

It should however be noted that the amount in excess of the statutory entitlement is taxable.

4. Compensation payments

It is not uncommon that an employee receives a lump sum payment as compensation in the case of early termination of employment by his or her employer. The taxability of such payment is often subject to dispute.

There are a number of case laws in the UK and Hong Kong concerning the taxability of compensation payments. Decisions handed down by the Courts in Hong Kong suggest that the following principle is heavily relied upon by the Court:-

- A payment is assessable if it is paid in return for "acting as" an employee since it is considered to be "an inducement to enter into employment and provide future services";



- A payment made in return for "being" an employee is also assessable since it represents "a reward for past services";

- A payment that is not paid for the above purpose but is paid for some other reason e.g. loss of office, cancellation of employment agreement, abrogation of rights would not be subject to tax;

- A payment should be viewed as a matter of substance and not merely of form.

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For a deeper discussion or any enquiry, please contact one of our members of the tax advisory team.



Gordon Oldham

Senior Partner

(852) 2522 6763

ggoldham@oln-law.com



Anna Chan

Senior Associate
LL.B.(Hons)
Master of Professional
Accounting

(852) 2868 0696

anna.chan@oln-law.com

Joey Chan

CPA
BBA (Hons) Accountancy

(852) 2868 0696

joey.chan@oln-law.com

Terence Siu

CPA

(852) 2868 0696

terence@oln-law.com



Jonathan Lam

Associate
LL.B.(Hons)

(852) 2868 0696

jonathan.lam@oln-law.com



Victor Ng

Associate
CPA

(852) 2868 0696

victor.ng@oln-law.com

K.F. Yan

CPA

(852) 2868 0696

kfyan@sg-cs.com