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The Commercial Unit, Civil Division
The Department of Justice

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Editorial

We feature three articles in this edition.

The first article outlines the main features of the Stamp Duty (Amendment) Ordinance 2024 which abolished all demand-side management measures for residential properties, namely Special Stamp Duty, Buyer's Stamp Duty and New Residential Stamp Duty with effect from 28 February 2024.

The second article discusses the Telecommunications (Amendment) Ordinance which amends the Telecommunications Ordinance to facilitate the grant of authorised access by the Communications Authority for mobile network operators to install and maintain mobile communications facilities in new buildings which is essential for enhancing Hong Kong's 5G network as well as future development in telecommunications technology.

The third article sets out the major enhancements made to the Deposit Protection Scheme by the Deposit Protection Scheme (Amendment) Bill 2024, one of which is to raise the protection limit from HK$500,000 to HK$800,000 on a per depositor per bank basis.

We also feature three case reports in this edition.

In the first case, the court had to decide whether, as a matter of construction in the light of the context or factual matrix of the case, a "letter of intent" was a binding agreement, or merely an agreement to agree.

In the second case, the court held that a clear intention to create a trust and the existence of a certain and identifiable subject matter of the trust were both important in determining whether a trust validly existed. While separation of funds was not essential, it was often an important indicator of a trust.

In the third case, the Court of Final Appeal held that a sum paid to an employee as compensation for his loss of rest days, statutory and public holidays due to being on call was income from employment and therefore chargeable to salaries tax.

YUNG Lap-yan

Stamp Duty (Amendment) Ordinance 2024

Introduction

The Stamp Duty (Amendment) Ordinance 2024 ("Amendment Ordinance") was enacted in April 2024 to abolish all previous demand-side management measures for residential properties ("DSMMs"), namely Special Stamp Duty ("SSD"), Buyer's Stamp Duty ("BSD") and New Residential Stamp Duty ("NRSD") with effect from 28 February 2024 (i.e. announcement date of the 2024-25 Budget).

This article outlines the major features of the Amendment Ordinance.

DSMMs

Maintaining the healthy and steady development of the private residential property market is one of the important objectives of the Government's housing policies. Against the backdrop of tight local housing demand-supply balance and ultra-low interest rates in the global monetary environment, the Government has introduced several rounds of the DSMMs (including SSD, BSD and NRSD) since 2010 to combat short-term speculative activities, curb external demand and reduce investment demand. The DSMMs are briefly described as follows:

(a) SSD was first introduced in November 2010 and further enhanced in October 2012 to combat short-term speculative activities by increasing the costs to speculators. SSD applies to residential properties acquired within the period from 20 November 2010 to 27 February 2024. It is imposed on the transactions of residential properties resold within 24 months at the rates ranged from 5% to 20%, depending on the holding period of the property. SSD applies equally to all Hong Kong permanent residents ("HKPRs") and non-HKPRs.

(b) BSD and NRSD were introduced in October 2012 and November 2016 respectively to curb external demand and to reduce investment demand, thereby stabilising the residential property market and according priority to the home ownership needs of HKPRs. BSD is imposed on all residential property transactions except for buyers who are HKPRs. NRSD is imposed on all residential property transactions except for buyers who are HKPRs and do not own any other residential property in Hong Kong. Before the abolition of the DSMMs, both BSD and NRSD were charged at a flat rate of 7.5% on the stated consideration or market value of the residential property (whichever was the higher), in addition to other chargeable stamp duty.

Adjustment of DSMMs before the Amendment Ordinance

In 2023, having regard to the then overall situation of the local residential property market, the 2023 Policy Address announced certain adjustments to the DSMMs with effect from 25 October 2023, including (a) shortening the resale period during which SSD can be charged from three years to two years; (b) reducing the respective rates of BSD and NRSD by half from 15% to 7.5%; and (c) implementing a stamp duty suspension mechanism for incoming talents' acquisition of residential properties ("Suspension Mechanism"). The relevant legislation, i.e. the Stamp Duty (Amendment) (Residential Properties) Ordinance 2024, was passed by the Legislative Council on 31 January 2024.

Abolition of DSMMs by the Amendment Ordinance

The Government has been closely monitoring the residential market development. Following the adjustments to the DSMMs since 25 October 2023, there has been no sign of market exuberance as a result of the relaxation. In 2024, the market conditions as well as the housing demand-supply balance have changed substantially as compared to the time when the DSMMs were introduced. Having considered the latest market situation and the high level of housing supply in the coming few years, the Financial Secretary announced in the 2024-25 Budget that all the existing DSMMs would be abolished with effect from 28 February 2024.

To effect the proposed abolition of the DSMMs, the Amendment Ordinance makes necessary amendments to the Stamp Duty Ordinance (Cap. 117) ("SDO"), with a view to retaining the legal framework for SSD, BSD and NRSD in the SDO. To this end, the Amendment Ordinance deliberately does not repeal the relevant provisions for SSD, BSD and NRSD. Instead, it lowers the rates of SSD and BSD to 0% and eliminates the higher rates charged under NRSD. This approach enables the Government to, as and when necessary in the future, reinstate the SSD/BSD/NRSD more readily by adjusting the relevant rates in the SDO.

After the abolition of the DSMMs by the Amendment

Ordinance, any residential property acquired on or after 28 February 2024 would only be subject to the previous lower rates set out in Scale 2 of the relevant heads in the First Schedule to the SDO, no matter the buyer is a HKPR or non-HKPR, with or without another residential property on hand.

Public Revenue Protection (Stamp Duty) Order 2024

Generally speaking, a bill or amendment bill will have the effect of law only after it is passed by the Legislative Council. However, for the abolition of the DSMMs, while the Amendment Ordinance was enacted in April 2024, the abolition had taken effect earlier on 28 February 2024. This was achieved by way of making the Public Revenue Protection (Stamp Duty) Order 2024 ("Order") by the Chief Executive pursuant to s.2 of the Public Revenue Protection Ordinance (Cap. 120) ("PRPO"). Pursuant to s.2 of the PRPO, "[i]f the Chief Executive approves of the introduction into the Legislative Council of a bill or resolution whereby, if such bill or resolution were to become law, (a) any duty, tax … would be imposed, removed or altered; or (b) any allowance in respect of a duty, tax … would be granted, altered or removed; or (c) administrative or general provision in relation to a duty, tax … would be enacted, altered or removed, the Chief Executive may make an order giving full force and effect of law to all the provisions of the bill or resolution so long as such order remains in force". Pursuant to s.5(1) of the PRPO, an order made under the PRPO shall come into force immediately upon the signing of the order by the Chief Executive unless some other time be specified in the order for its coming into force.

The duration of an order made under the PRPO is limited. Pursuant to s.5(2) of the PRPO, every order made under the PRPO shall expire and cease to be in force (a) upon the notification in the Gazette of the rejection by the Legislative Council of the bill or resolution in respect of which the order was made; (b) upon the notification in the Gazette of the withdrawal of the bill or resolution or order; (c) upon the bill or resolution, with or without modification, becoming law in the ordinary manner; or (d) upon the expiration of 4 months from the day on which the order came into force, whichever event first happens.

Sandy Hung

Telecommunications (Amendment) Ordinance 2024

Introduction

The fifth generation mobile ("5G") services have been launched in Hong Kong since April 2020. As of 2023, 5G coverage has reached 90% of our population. Despite having one of the highest 5G penetration in the world, there is still room for improvement of 5G coverage and related mobile services in some remote regions, new development areas and old districts in Hong Kong.

Currently, most of the mobile communications facilities (the "MCFs") installed by mobile network operators (the "MNOs") are located in densely populated urban areas and at sites of private buildings. In order to provide ubiquitous 5G network coverage with high-speed and high-capacity data transmission to meet the demand of various innovative applications, a large number of 5G MCFs will need to be installed at different height levels and locations, including roof-tops and other locations at intermediate / lower levels of buildings.

In this connection, in the 2022 Policy Address, the Chief Executive announced the Government's plan to amend the Telecommunications Ordinance (Cap. 106) (the "TO") and relevant guidelines to ensure that appropriate space is made available in new buildings for the installation of MCFs by relevant MNOs, which is crucial to the expansion of 5G network coverage in Hong Kong and the facilitation of Hong Kong's development into a smart city.

Against that background, the Legislative Council passed the Telecommunications (Amendment) Ordinance (the "Ordinance") on 21 February 2024, which amends the TO to facilitate the grant of authorised access for MNOs to install and maintain MCFs in new buildings.

Current Regime

Currently, the TO provides that –

(a) fixed network operators (the "FNOs" may general or for any particular occasion be authorised by the Communications Authority (the "CA") to enter upon any land or seabed to, among others, place and maintain telecommunications lines without the payment of any fee to the persons having a lawful interest in the land concerned (e.g. landowners); but

(b) the grant of the CA's authorisation to MNOs for access to private properties for MCFs, unlike the case of FNOs above, is subject to stringent criteria[1] and the payment of a fee[2] to the persons having a lawful interest in the land, with the amount of such fee to be determined by agreement between the relevant MNOs and landowners or by arbitration in the absence of any such agreement.

Given the regulatory regime under the TO, over the years, MNOs wishing to gain access to private properties for the installation of MCFs could only do so through reaching an agreement with the respective landowners as to the fee to be paid. This involves commercial negotiations that are often protracted. Besides, there is often a lack of suitable floor space or ancillary facilities (e.g. cable duct, electricity supply) in buildings for the installation of MCFs, or the landowners simply refuse to negotiate with the MNOs concerned. All these factors have hindered further the installation of MCFs and expansion of mobile communications service coverage which are essential in enhancing Hong Kong's 5G network as well as future development in telecommunications technology.

As the installation of MCFs in, and for that purpose, gaining access to, private buildings by MNOs is pivotal to bringing significant improvement to the 5G network in Hong Kong, it is necessary to amend the TO such that MNOs may more readily be granted access right to new buildings for the installation and maintenance of MCFs.

<u>The Ordinance</u>

The Ordinance aims to provide legal backing for the CA's authorisation for the MNOs to enter reserved spaces in new buildings for installing and maintaining MCFs, without being subject to any stringent criteria and payment of any fee to the persons having a lawful interest in the land. In other words, access right to such new buildings may be granted to MNOs by the CA in respect of the installation and maintenance of MCFs as readily as access right that may be granted to FNOs under the current regime.

<u>Measures Required for Implementation of the Ordinance</u>

To implement the Ordinance, other measures have to be taken.

The CA will issue a Code of Practice, with which MNOs are required to comply under the relevant telecommunications licences. The Code of Practice will list out the minimum standards / requirements of the infrastructure for the installation of MCFs in new buildings.

The Buildings Department will update the relevant Practice Note to specify the design and associated requirements in the new buildings to provide suitable floor space and ancillary facilities (e.g. cable ducts) for the installation of MCFs, by adopting those requirements in the Code of Practice, for the statutory compliance by relevant building developers and construction professionals.

At present, installation of MCFs in a private residential or non-commercial building for provision of mobile communications services serving customers outside the building requires a waiver issued by the Lands Department since such installation is considered to be commercial in nature. The Lands Department will make suitable provisions in new land leases to allow such installation of MCFs without a need to apply for the waiver.

The Housing Department will reserve space and facilities at the new public housing developments in accordance with the updated Practice Note and formulate administrative arrangements to enable MNOs' access to the reserved space in the public housing developments for installing and maintaining MCFs.

To allow time for preparing the above measures, the main provisions of the Ordinance did not take effect on its passage and the Secretary for Commerce and Economic Development is empowered to appoint the commencement date by notice published in Gazette.

Silvia Tang

1 The criteria are provided for in sections 14(1A) and (1B) of the TO.

2 Sections 14(1D) and (2)(ii) of the TO.

Deposit Protection Scheme (Amendment) Bill 2024

Introduction

Deposit protection is a core element of a robust financial safety net. In Hong Kong, the Deposit Protection Scheme ("DPS") was set up in 2006 under the Deposit Protection Scheme Ordinance (Cap. 581) ("DPSO") with the objective of protecting depositors in the event of bank failure. It contributes to banking stability by reducing the risks of bank runs and financial contagion.

DPS is operated by the Hong Kong Deposit Protection Board ("Board"), an independent statutory body established under DPSO. The salient features of DPS are:

(a) all licensed banks are DPS members unless exempted by the Board;
(b) most types of deposits, including those denominated in Renminbi or foreign currencies, are covered by DPS as protected deposits;
(c) the current protection limit is HK$500,000 per depositor per bank; and
(d) DPS is backed by the Deposit Protection Scheme Fund ("DPS Fund") established under DPSO. DPS members contribute to DPS Fund by way of levies.

Latest review of DPS

The Board regularly reviews DPS to ensure that it remains effective in contributing to banking stability and keeps up with international best practice. The latest review initiated in 2021 shows that DPS is in line with international standards on most fronts. However, improvement may be made as to (i) the protection limit, (ii) the levy system, (iii) deposit protection arrangements in case of bank merger or acquisition, and (iv) the display of DPS membership sign and the negative disclosure requirement on non-protected deposits. The Board has proposed enhancements for those aspects.

The Amendment Bill

The Deposit Protection Scheme (Amendment) Bill 2024 ("Amendment Bill") was introduced to the Legislative Council on 8 May 2024. It seeks to amend DPSO and the Deposit Protection Scheme (Representation on Scheme Membership and Protection of Financial Products under Scheme) Rules (Cap. 581A) ("DPS Rules") to implement the following enhancements proposed by the Board:

(a) raise the protection limit from HK$500,000 to HK$800,000;
(b) refine the levy system to enable the DPS Fund to reach the target size within a reasonable time;
(c) enhance protection of depositors in case of bank merger or acquisition;
(d) require the display of DPS membership sign on the electronic banking platforms of DPS members; and
(e) streamline the negative disclosure requirement on non-protected deposit transactions for private banking customers.

Raising the protection limit

The protection limit, being a key feature of DPS, is set out in DPSO. It started from HK$100,000 and was raised to the current limit of HK$500,000 in 2011. With depositors' increasing income and savings over time, the current limit covers only around 88%-89% of depositors, which is below the standard of 90% as recommended by the International Association of Deposit Insurers ("IADI"). Hence, there is a need to raise the protection limit. Having considered the inflation rates, IADI's recommendations and other jurisdictions' deposit protection schemes, as well as the need to strike a balance between enhancing depositor protection and keeping the additional costs/moral hazard risk at manageable levels, it is proposed that the protection limit as set out in DPSO be raised to HK$800,000.

Refining the levy system

Deposit protection comes with costs. When compensation under DPS becomes payable in respect of a DPS member, the Board borrows from the Exchange Fund under a standby liquidity facility to pay compensation to depositors, and then seeks to recover the payout from the liquidation of the failed DPS member. The cost of borrowing from the Exchange Fund, any compensation paid that cannot be recovered from the liquidation, and the relevant administrative cost incurred by DPS are all charged to DPS Fund.

DPSO requires that the target size of DPS Fund be kept at 0.25% of total protected deposits. If the protection limit is raised to HK$800,000, the monetary amount of the target size will increase from HK$6.3 billion to HK$8.2 billion. To ensure that the new target size can be reached within a reasonable time, amendment to the existing levy system under DPSO is proposed. The circumstances under which the levy can be charged against DPS members are proposed to be broadened to cover the situation when the protection limit is raised.

Enhanced protection in case of bank merger or acquisition

At present, the deposit protection under DPS is on a per depositor per bank basis. This means that if two or more banks merge, depositors who have deposits with those banks will only be protected up to the standard protection limit at one merged bank.

Having considered that bank mergers do happen in Hong Kong and that IADI has updated the core principles on deposit protection in case of bank merger or amalgamation, amendments to DPSO are proposed to provide for an enhanced depositor protection mechanism at times of bank merger or acquisition. Depositors who have deposits with more than one DPS members will be entitled to compensation in respect of his protected deposits with each of the original DPS members up to the standard protection limit for a period of six months from the date of merger or acquisition, which period could be lengthened if the deposit concerned has a maturity date that falls after the expiry of the six-month period. DPS members involved in the merger or acquisition would be required to notify the affected depositors and the Board of the transitional arrangement on or before the effective date of merger or acquisition.

Other enhancements

As electronic platforms have become the major channel for delivering banking services in recent years, the DPS Rules are proposed to be amended, requiring DPS members to display a DPS membership sign at their electronic platforms (e.g. websites and mobile applications) in addition to their physical branches.

Amendments are also proposed to be made to the DPS Rules such that a DPS member may choose to apply a streamlined approach when dealing with private banking customers in respect of deposit products not protected by DPS. This aligns with the arrangement for institutional customers and is commensurate with the investment knowledge and experience of private banking customers.

Blondie Poon

Bonds Group Company Limited v Kwan Daniel & Ors [2023] HKCU 5313

Facts

The defendants ("Ds") were shareholders of a company (the "Company"), which was the registered owner of a property where a residential development (the "Development") was built. In 2017, Ds entered into a "Letter of Intent for Company Share Transfer" ("LOI") with the plaintiff company ("P") under which P was to invest $245 million to acquire 70% shareholdings of the Company. The Development was valued at $800 million at the relevant time.

Clause 10 of the LOI sets out the timeframe for completion of the due diligence on the Company and consists: (a) Clause 10a that prohibits Ds from third parties negotiation during the due diligence period, and (b) Clause 10b that stipulates mechanism for damages in case of Ds' breach of the relevant provisions in the LOI. Under the LOI, parties were required to sign an agreement for sale and purchase and a shareholders' agreement ("Formal Agreements") as soon as practicable after completion of the due diligence process, and Ds were required to submit a letter of undertaking concerning the shareholdings ("Ds' Undertaking") to P.

After execution of the LOI and P's commencement of due diligence, one of the Ds informed P by telephone that he wished to terminate the LOI.

P commenced proceedings against Ds seeking damages for breach of the LOI. D argued that, first, the LOI was not a legally binding agreement between the parties because the time and/or date with respect of the payment for the purchase price had not been agreed upon. Second, the true nature of the LOI was merely an offer to P to perform due diligence on the Company, and if Ds refused to make any deal with P eventually, Ds agreed to pay for the damages according to the mechanism stipulated in Clause 10b.

The deputy high court judge ("Judge") in the Court of First Instance ruled in favour of Ds. P appealed to the Court of Appeal ("CA").

CA's Decision

Non-binding Part of the LOI

The CA ruled that the LOI was not a binding agreement in respect of the sale and purchase of the shareholdings due to lack of essential terms and parties' intention to be legally bound. It was binding only in respect of the part on due diligence.

The CA considered that the question whether an agreement consists of the essential terms and is binding is fact specific. It is a matter of construction of the agreement in the light of the context or factual matrix of the case: *British Steel Corp v Cleveland*

Bridge & Engineering Co Ltd.[3]

On the issue whether the parties intended to create legal relations, the CA referred to *Barbudev v Eurocom Cable Management Bulgaria EOOD*[4], where Aikens LJ stated that one must look at the objective conduct of the parties as a whole and emphasized that one must look at the whole circumstances of the case.

In this case, the difficulties faced by P were that, quite apart from the lack of provisions for the time of payment of the $245 million and the completion date for the sale and purchase of the shareholdings, there were also other important outstanding matters to be resolved by the parties in relation to the Formal Agreements and Ds' Undertaking. For instance, the likely provisions in a shareholders' agreement such as deadlock, minority protection, termination, restriction of sale of shares, pre-emptive rights, relationship with the articles of association were missing and could only be worked out by the parties and not the court. Likewise, the extent of Ds' Undertaking in regard to the shareholdings, creditors' rights, debts and other matters of the Company was not settled. These outstanding essential matters were not matters that the court could decide for the parties. All these pointed towards the view that the LOI was not a legally binding agreement in respect of the sale and purchase of the shareholdings.

As regards the terms in LOI which required signing of the Formal Agreements and submission of Ds' Undertaking as soon as practicable after completion of the due diligence, the CA considered that this aspect of the LOI dealing with the sale and purchase of the shareholdings was no more than an agreement to agree: *Walford and Another v Miles and Another*[5], where Lord Ackner referred to the long established principle that an agreement to negotiate cannot constitute a legally enforceable contract.

Lilian Chiu

Hip Hing Construction Co Ltd v Hong Kong Airlines Ltd [2024] HKCFI 370

Facts

The Plaintiff ("P"), a construction company, entered into a contract ("Contract") with the Defendant ("D"), an airline, for the construction of a training centre at Chek Lap Kok. Pursuant to clause 32.5 of the General Conditions of the Standard Form of Building Contract incorporated into the Contract ("GCC 32.5"), D shall hold a specified percentage of a certified sum payable to P by D as retention money on trust for P. GCC 32.5 did not specify the exact amount of retention money to be held on trust by D for P. Such exact amount was to be calculated based the amount certified in a payment certificate to be issued by P to D.

D subsequently defaulted in payment for works carried out by P under the Contract. On 4 March 2022, a winding-up petition was presented against D. A scheme of arrangement ("Scheme") and restructuring plan were sanctioned by the Court for D in December 2022 and took effect in April 2023. The winding-up petition against D was dismissed.

In May 2023, considering there to be a serious question to be tried on P's claim, the Court granted a mandatory injunction pending trial to compel D to pay a sum of about HK$56 million into a separate account, in accordance with the trust arrangement specified in GCC 32.5. It was not disputed that such HK$56 million was the correct amount of retention money ("Retention Money") calculated in accordance with GCC 32.5 and the relevant payment certificate.

In response to the mandatory injunction, D paid the Retention Money but instead of paying it into a separate account, D paid it into its existing bank account. D undertook not to apply the funds in that bank account until the substantive hearing of the present case or until further order of the court.

It was not disputed that prior to the above payment by D in response to the mandatory injunction, no Retention Money was paid into any separate bank account of D or segregated from the rest of D's funds ("Segregation").

P sought a declaration that D held the Retention Money on trust for P pursuant to GCC 32.5. If such purported trust over a part of the bulk of D's funds calculated in accordance with GCC 32.5 and the relevant payment certificate ("Purported Trust") could be upheld, the Retention Money would not form part of the assets under the Scheme but would go to P instead.

Issues

The issues were whether Segregation was necessary for the existence of the Purported Trust and, in the absence of Segregation, whether the subject matter of the Purported Trust was too uncertain to validly create the Purported Trust.

[3] [1984] 1 All ER 504, 509
[4] [2012] 2 All ER (Comm) 963
[5] [1992] 2 AC 128 where at page 137

Relying on *Hunter v Moss*[6], P argued that Segregation was not necessary in that certainty of subject matter could be satisfied for fungible and interchangeable property (e.g. money) so long as the mass was sufficiently identified and that the beneficiary's proportionate share of it was not uncertain.

In contrast, D contended that the lack of Segregation made the subject matter of the Purported Trust uncertain and hence, the Purported Trust had not been validly created for P. D further cited the decision of *MacJordan Construction Ltd v Brookmount Erostin Ltd*[7] and argued that there was no good reason for the Court to permit P to bypass the equal distribution under the Scheme as sanctioned by the Court, when no fund had been set aside as the Retention Money prior to the mandatory injunction.

Decision

The Court considered that a clear intention to create a trust and the existence of a certain and identifiable subject matter of the trust were both important in determining whether a trust validly existed. While separation of funds was often an indicator of a trust, the absence of it did not necessarily mean that no trust was intended, or that the subject matter of the trust must be uncertain. The Court would have to look at all circumstances to reach a conclusion.

In the present case, GCC 32.5 expressly provided that money shall be held on trust as retention money by D for P. The Court considered that GCC 32.5 clearly manifested the intention of both P and D to create a trust.

Having said that, there must be certainty of the subject matter of a trust before a valid trust could exist. In this case, the intended subject matter of the Purported Trust was a specified percentage of the sum certified as payable to P by D in accordance with GCC 32.5 and the relevant payment certificate. However, at the substantive hearing, P only identified that the subject matter of the Purported Trust as all the money in any and all bank accounts of D. P failed to provide any evidence to show that the Retention Money was paid into any specific account which could be identified. P also failed to provide any evidence to show any specified bank account(s) of D which could be argued to be related to the source of the Retention Money.

In the absence of evidence provided by P, the Court concluded that P's argument was merely that D held HK$56 million of its funds as Retention Money on trust for P. Such a broad assertion without identifying any source or specified account(s) that D should allocate the Retention Money to P rendered the subject matter of the Purported Trust too vague and uncertain, and that it would be difficult, if not impossible, for the Court to enforce or regulate the Purported Trust.

Eventually, the Court held that the Purported Trust was not established for lack of certainty of the subject matter and that the Retention Money was to form part of D's assets to be dealt with in accordance with the terms of the Scheme.

Noting that GCC 32.5 was generally intended to protect contractors against the insolvency of the companies which engaged the contractors, the Court remarked that it was unfortunate that P had been deprived of the intended protection as a result of D's failure to put the Retention Money into a segregated account. The Court made a further remark that contractors could be advised to be vigilant in safeguarding their rights by applying to the court at an early stage for an execution order of the trust, rather than to wait at their own risk in the event that the companies which engaged the contractors became insolvent, or the trust property was otherwise dissipated.

Lawrence Li

Dr. The Honourable Leung Ka-Lau v The Commissioner of Inland Revenue [2023] HKCFA 36

Background

The present case was associated with a previous Court of Final Appeal's judgment in *Leung Ka Lau and Others v The Hospital Authority*[8] ("2009 CFA Judgment"), which held that Dr. Leung Ka Lau ("Taxpayer") and other doctors employed by the Hospital Authority ("HA") were deprived of the entitlement to rest days, statutory and public holidays under the Employment Ordinance (Cap. 57) ("EO") due to being on call.

Consequently, the Taxpayer was awarded a sum of HK$1,765,821 ("Sum") as compensation for his loss of rest days, statutory and public holidays from 17 March 1996 to 1 October 2005.

Board of Review's Decision

S.8(1) of the Inland Revenue Ordinance (Cap. 112) ("IRO") provides that "*[s]alaries tax shall, subject to the provisions of this Ordinance, be charged for each*

6 [1993] 1 WLR 934
7 [1994] CLC 581
8 (2009) 12 HKCFAR 924

year of assessment on every person in respect of his income arising in or derived from Hong Kong from the following sources— (a) any office or employment of profit ...".

Following the 2009 CFA Judgment, the Commissioner of Inland Revenue ("CIR") determined that the Sum was chargeable to salaries tax under s.8 of the IRO for the year of assessment 2012/13. The Taxpayer's appeal against this determination was dismissed by the Board of Review ("Board").

CFI's Judgment

The Taxpayer appealed to the Court of First Instance ("CFI"), where the judge formulated the question of law as follows: whether the Board erred in law in finding that the Sum was income from employment within the meanings of s.8(1) of the IRO.

The judge found that the Sum had dual characteristics: (a) compensation or damages for the HA's breach of contract; and (b) payment to the Taxpayer for having performed work under the employment contract. The substance of the Sum was to compensate the Taxpayer for the loss of rest days and public holidays. Since the Taxpayer was already taxed on his remuneration package, taxing the Sum would subject him to double taxation.

Accordingly, the CFI answered the question of law in favour of the Taxpayer and allowed the Taxpayer's appeal.

CA's Judgment

The CIR appealed to the Court of Appeal ("CA"). The majority of the CA considered that the payment of the Sum was not provided for in the contract of employment. Rather, the Sum was consideration payable to the Taxpayer for depriving him of his right to a day of absence from work, which was for abrogation of his right under the EO and the contract of employment, and was not in substance "income from employment".

As such, the CA held that the Sum was not income from employment within the meanings of s.8(1) of the IRO and not assessable to salaries tax, thus dismissing the CIR's appeal.

CFA's Judgment

The CIR appealed to the Court of Final Appeal ("CFA"). The ultimate issue was whether the Sum was income from employment.

Applying the test for taxation from employment as set out in *Fuchs v Commissioner of Inland Revenue*[9], the CFA held that the Sum, viewed as a substance rather than form, arose out of employment for the following reasons:

(a) The purpose for which the Sum was paid arose from the Taxpayer acting as or being an employee. The Taxpayer was required to be on standby, holding himself ready to go to the hospital at any time. This was what the Sum was intended to compensate. The Taxpayer stood by on his holiday and rest day because he was an employee of the HA, and in doing so, he was "acting as or being an employee".

(b) The Sum may be viewed as a payment for past services. The Taxpayer provided a service to the HA by being on stand-by, even if he was not called to go to the hospital. The HA had a responsibility to properly staff its hospitals on holidays and statutory rest days, in part, by requiring the Taxpayer to be on call and stand by on those days. That was a past service the Taxpayer provided to the HA.

(c) The contract terms that provided for holidays and rest days, of which the Taxpayer was deprived, may be viewed as an inducement to prospective employees to enter into a contract for services with the HA, which was related to employment under the *Fuchs* test.

Then, the CFA considered the following arguments from the Taxpayer but rejected them:

(a) The first argument was that the Sum was not paid pursuant to the contract of employment, but rather to abrogate the Taxpayer's rights. The CFA distinguished the "abrogation cases" from the present case – the "abrogation cases" were concerned with situations where the employment of the taxpayer was brought to an end, but the contract of employment in the present case was never terminated and remained fully in force at all times. The Taxpayer's right to be paid for the days he was on stand-by did not negate or "abrogate" those terms. The Taxpayer relied on the terms of the contract and his rights and asked that he be given compensation for the failure to fulfil them. This was not abrogation of the contractual rights, but a demand that they be fulfilled.

(b) The second argument was that the Sum was damages for the HA's breach of the EO, and hence the Sum arose from the HA's infraction of the

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ordinance but not the contract of employment. The CFA was not convinced and took the view that while the HA may have arguably violated the EO, the principal reason the payment was ordered was the entitlement for the Taxpayer's standing by on holidays and rest days.

(c) The Taxpayer's double taxation argument was also discussed. The CFA considered that the Sum as ordered in the 2009 CFA Judgment was paid to the Taxpayer as compensation for his loss of rest days and holidays. The Sum was thus over and above the basic monthly salary of the Taxpayer and therefore had not been previously taxed.

Conclusion

Accordingly, the CFA unanimously allowed the appeal and held that the Board did not err in law in finding that the Sum was income from employment within the meaning of s.8(1) of the IRO.

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