

# Tax Consequences on Termination Payments

Date : 18 May 2020

## *Introduction*

Due to the COVID-19 pandemic, many industries, such as aviation, tourism, hotel, hospitality, retail and catering, have been severely impacted. As a result, various employees, such as pilots and salesmen, have been dismissed by their employers. Some of those employees may be entitled to termination/redundancy/severance packages from their employers, such as a reward for their past contributions, a compensation for loss of employment, cancellation of employment contract and/or surrendering of certain rights. Those employees may have concerns whether these termination/redundancy payments will be liable to the Hong Kong salaries tax.

## *Relevant tax rules in Hong Kong*

Pursuant to the Hong Kong Inland Revenue Ordinance, income from employment arising in or derived from Hong Kong shall be subject to Hong Kong salaries tax. The income from employment includes, amongst others, gratuity and perquisite, the base of which is rather broad. It is sometimes disputable between taxpayers and the Inland Revenue Department whether a termination/redundancy payment is taxable or not. Some cases have been put forward to the Courts for determination.

In general, a termination payment made by an employer to its employee as a reward for his/her employment services in the past, present or future is taxable in Hong Kong. Taxpayers have been claiming termination payments as non-taxable based on various grounds, such as being a compensation for breach of employment contract, loss of an office or abrogation of rights. In addition, it has been argued by taxpayers that payments to induce them to resign or accept a retirement or redundancy package should be non-taxable.

Lump sum termination payments may include several natures of payment, such as gratuity for the past services and compensation for loss of office. It is possible for those lump sum termination payments to be apportioned into taxable and non-taxable components as long as they can be justified.

## *Conclusion*

When determining whether a termination payment is subject to Hong Kong salaries tax or not, one has to look into the relevant facts and circumstances leading to the termination payments including the relevant documents, such as employment contracts and the correspondences exchanged between the employers and employees.

In order to mitigate the chance of disputes, it is suggested for the employers and employees to have documented in writing, detailed information about the relevant termination payment including its nature and respective amount as well as the circumstances leading to the payment.

If necessary, one may seek advice from the tax specialists regarding the tax consequences.