Inland Revenue Department
Hong Kong

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

NO. 41

SALARIES TAX

TAXATION OF HOLIDAY JOURNEY BENEFITS

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Commissioner of Inland Revenue

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INTRODUCTION

Following the enactment of the Revenue (No.2) Ordinance 2003 which came into effect on 1 April 2003, it is considered necessary to explain the background and reason for amending section 9 of the Inland Revenue Ordinance ("the Ordinance") and to lay down broad statements on the interpretation and practice to be adopted by the Inland Revenue Department ("the Department") in relation to the amendments.

THE POSITION BEFORE THE AMENDMENTS

2. Prior to 1 April 2003, the value of any holiday warrant or passage granted by the employer was exempt from salaries tax, as long as the benefit had been used for travel [section 9(1)(a)(i) of the Ordinance]. This exemption was extended to any allowance for the purchase of such holiday warrant or passage [section 9(1)(a)(ii)] as well as any allowance for the transportation of the employee's personal effects in connection with the holiday warrant or passage [section 9(1)(a)(iii)], in so far as they had been used for the specified purposes.

BACKGROUND TO THE AMENDMENTS

3. Departmental Interpretation and Practice Notes No.16 sets out in detail the Departmental views and practice on the taxation of fringe benefits for salaries tax purposes. In essence, the Departmental assessing practice before the *Glynn v CIR case (1989) 3 HKTC 245* was that benefits derived by an employee or office-holder from his employer or others in a form other than money, unless otherwise covered by specific provisions in the Ordinance, could only be chargeable to tax if they took the form of "money's worth", which means the benefit either is convertible into money by the employee or involves the discharge of a personal liability of the employee. The *Glynn* case confirmed the assessing practice but at the same time held that inconvertible benefits, subject to certain exceptions, could be chargeable to tax. To bring back the pre-Glynn assessing practice and contain the effect of the *Glynn* case, several new provisions were added to the Ordinance in 1991:

(a) section 9(1)(a)(iv) excludes [subject to subsection (2A)] from chargeability any benefit where the relevant payment is one for which the employer has the sole liability. This means that any payment made by an employer to discharge a liability of an employee would continue to be chargeable to salaries tax as previously;

(b) section 9(2A)(a) ensures that convertible benefits remain chargeable to salaries tax notwithstanding that the liability for the relevant payment rests with the employer; and

(c) section 9(2A)(b) retains the chargeability on any amount paid by an employer in connection with the education of a child of an employee.

4. Holiday warrants and passages were the only type of fringe benefit specifically exempt from salaries tax. To make the tax system more equitable, the Financial Secretary proposed in his Budget Speech for 2003-04 that the exemption be removed. The proposal was enacted via the Revenue (No.2) Ordinance 2003 by removing the exemption clauses in section 9(1)(a)(i) to (iii) of the Ordinance.

5. The implications of the above removal, without any other steps, would have been that holiday warrants and passages would have been assessed according to the general taxing principles on benefits-in-kind referred to in paragraph 3 above, i.e. it will be assessed if it is capable of being converted into money, or it involves a discharge of the employee's personal liability to pay for the passage. On the other hand, a holiday warrant or passage not convertible into money and not involving a discharge of the employee's personal liability would continue to be exempt. For example, an employer may convert a holiday warrant or passage allowance into an air ticket or a holiday tour and give it tax-free to his employee (and/or the employee's family members). This clearly would have presented an opportunity for tax avoidance.

6. The Administration considered that the perceived avoidance above-mentioned needed to be addressed. In this regard, the international practice is to tax a holiday journey benefit either by reference to its market

value or the cost incurred by the employer. Of these 2 approaches, the Administration decided to follow the latter one, i.e. to tax the cost incurred by the employer since it is sometimes difficult to assess the market value of a benefit. Therefore, apart from the deletion of section 9(1)(a)(i) to (iii), further amendments were required to plug the loophole and to bring the law more in line with the international practice.

AMENDMENTS TO SECTION 9(2A)

7. By virtue of section 9(1)(a) of the Ordinance, all perquisite and allowance (among others), whether derived from the employer or others, are included as income from an office or employment and are thus chargeable to tax. As mentioned in paragraph 3, section 9(1)(a)(iv) provides an exception in that any amount paid by the employer to a third party in discharge of the employer's own contractual liability is not to be included as the employee's income. In addition, section 9(2A) provides that the exemption under section 9(1)(a)(iv) will not apply where –

(a) any benefit is capable of being converted into money by the recipient; or

(b) any amount paid by an employer is in connection with the education of a child of an employee.

8. To redress the situation envisaged in paragraph 5 above, section 9(2A) was amended by adding a third scenario under which the exemption provided by section 9(1)(a)(iv) shall not apply, viz. –

"(c) any amount paid by an employer in connection with a holiday journey,".

9. The opportunity was also taken to amend section 9(2A)(a) to the effect that where a holiday journey benefit is convertible into cash, that benefit is to be assessed by reference to the actual amount paid by the employer for such benefit under the new section 9(2A)(c), instead of the amount to which the benefit would be converted.

10. The effect of the above amendments is to subject all payments by an employer in connection with a holiday journey to tax, irrespective of whether it is convertible into cash and whether the primary liability for the benefit is the employee's own. The amount to be assessed is based on the actual amount paid by the employer, i.e. the actual costs that an employer pays.

11. It should be noted that where a holiday journey benefit is associated with or attributable to a cost paid by an employer, that benefit is taxable notwithstanding that the employer does not incur additional, or incremental, costs for that benefit. For example, an employee under the employer's existing travel policy is entitled to travel business class in respect of business journeys undertaken for the employer. On a particular business journey, the employee trades in the business class air ticket for 2 economy class tickets so that the spouse can travel with him/her. In this case, although there is no incremental cost incurred by the employer in providing the spouse's air ticket, the cost of the spouse's ticket is actually borne by the employer. It is therefore taxable.

12. Following the principle enunciated in the foregoing paragraphs, airline staff who benefit from discounted or free air tickets from their employer will not be taxed on the benefit if their employer does not have to pay for the air tickets. In this connection, the marginal costs incurred by the employer in providing employees with seats on the plane will be ignored. So will be the opportunity costs at which the air tickets could have been sold.

HOLIDAY JOURNEY AND BASIS OF ASSESSMENT

13. The term "holiday journey" is defined in section 9(6) as either "a journey taken for holiday purposes" or "where a journey is taken for holiday and other purposes, the part of the journey taken for holiday purposes". The first arm covers cases where the journey is taken exclusively for holiday purposes. The second arm covers cases where the journey is taken for 2 or more purposes one of which is a holiday purpose. In such a case, that part of the journey relating to the holiday purpose will fall within the meaning of the term "holiday journey". It also follows from the statutory definition that where a trip is only for a non-holiday purpose, e.g. a business trip, the associated costs will not be taxable.

14. In cases where a trip is taken partly for business and partly for holiday, the Department will look at the immediate purpose of the trip; if a holiday was merely incidental to a business trip, the Department will refrain from taxing the benefit. (As a corollary, where a business dealing by an employee is merely incidental to his holiday journey, e.g. visiting a business contact on his way, the whole journey is to be treated as being for holiday.) However, in cases where a clearly identifiable part of the journey is taken for holiday purposes, the expenses relating to that part of the journey will have to be ascertained and assessed to tax accordingly.

15. It is difficult to lay down precise formulae for ascertaining the expenses relating to that part of a journey expended for holiday purposes in a business-cum-holiday situation. All the circumstances of the case will have to be taken into account to arrive at a fair and reasonable amount. A rule of thumb for this purpose is that where the expenses are distinct and separable (e.g. accommodation costs for the extra nights spent on holiday), such expenses will be assessed. Where the expenses are not so distinct and separable, an apportionment based on the "holiday-days basis" will generally be adopted, i.e. the total amount spent for the combined journey *times* the number of days spent on holiday *divided by* the total number of days in the journey. In either case, the cost of the air ticket would normally not be apportioned since that cost would have to be incurred irrespective of the holiday element.

16. Where a business trip spans over weekends, such weekend days (Saturdays and Sundays) will normally not be regarded as a holiday journey and therefore will not need to be added to the number of holiday days, if any, for the purpose of cost apportionment. However, the same does NOT apply where weekend days precede or succeed a business trip since the business trip would not have yet started, or would have already finished, as the case may be.

17. Another situation is where an employee is required to travel to many locations in one single trip and due to routing or other reasons, stopovers were made in between the places visited. Such stopovers will be regarded as incidental to the business journey if the stopover days were not excessive having regard to the circumstances of the case.

18. For holiday journeys organized by an employer (or purchased by an employer from a travel agency) on a group basis where the amount paid by the

employer is not distinct and separable for individual employees, say a 1-day Hong Kong tour for a group of employees, an apportionment on a head count basis may be adopted.

19. It should be noted that the "amount paid" for a holiday journey refers to all kinds of expenses "in connection with" such a journey. This would include expenses on air, land or sea transportation, accommodation, meals, sightseeing tours, travel insurance and visa fees, etc. On the other hand, if it could be established that a journey is not for holiday, such as for the relocation of an employee and his family in or out of Hong Kong upon assumption of a new post or termination of an existing post here, as the case may be, the payment made by the employer would be out of the scope of the charge. For any such trips, any stopover visits to another place en route to or from Hong Kong would be disregarded as a concession.

20. Annual home trips provided to expatriate staff and their family members are normally for holiday purposes. They are therefore assessable under the usual rules.

21. If any costs of holiday travel are not taxable, they do not need to be reported by the employer. If there is some doubt as to whether the exemption applies, the employer should make a note about this in the relevant Employer's Return of Remuneration and Pensions, and the employees concerned should likewise make a similar note in their own tax returns. The employer may also clarify borderline cases with the assessor in the first place. However, this should be done well in advance of the return filing deadline.

22. If a taxpayer is assessed on a holiday journey benefit but considers that such benefit should not be assessed or that the amount assessed is excessive, he/she can raise the issue through the usual objection and appeal procedures.

EXAMPLES

23. It is not possible to give an exhaustive list of the different situations of when and how to assess holiday journey benefits. The following examples illustrate the practice to be adopted by the Department in respect of the various scenarios described in the foregoing paragraphs.

Example 1

In the year of assessment 2003-04, Employer A granted an allowance of $30,000 to Mr. Chan for him to take a holiday tour during his annual leave. Employer A however did not require that the allowance be actually expended for such a purpose. Mr. Chan spent $10,000 for a holiday tour taken in July 2003 during his annual leave and pocketed the remaining $20,000.

Following the deletion of the exemption provision in section 9(1)(a)(ii), the allowance of $10,000 for the holiday tour would form part of Mr. Chan's assessable income for the year of assessment 2003-04. Whether or not Employer A exercised any control over the use of the allowance was irrelevant. The balance of $20,000 will also be assessed as an income from employment under section 9(1)(a) of the Ordinance.

Example 2

In the year of assessment 2003-04, Mr. Lee joined an 8-day leisure tour to Europe held by a travel company. Mr. Lee was invoiced $20,000 by the travel company for the tour. To recognize Mr. Lee's good work performance, Employer B settled the invoice amount of $20,000 for Mr. Lee directly with the travel company.

The discharge of Mr. Lee's personal liability in the amount of $20,000 by Employer B is money's worth and would therefore be included as Mr. Lee's assessable income for the year of assessment 2003-04. The position is not affected by the amendments made by the Revenue (No.2) Ordinance 2003.

Example 3

In the year of assessment 2003-04, Employer C paid $60,000 to a travel company to purchase a package tour to Australia to be taken by Mr. Ho with his wife and 2 children for holiday purposes. The package tour could not be transferred to other persons. Employer C also paid $3,000 to take out a family travel insurance policy for Mr. Ho.

Although the package tour was not convertible into money, the total amount of $63,000 was paid by Employer C in connection with a holiday journey taken

by Mr. Ho and his family members. Therefore, under the new section 9(2A)(c), such amount would be included as Mr. Ho's assessable income for the year of assessment 2003-04.

Example 4

In the year of assessment 2003-04, Employer D paid $3,000 to purchase a tour coupon, which entitled the holder to take a 2-day guided tour to Macau, and gave it to Mr. Wong for him to spend his holiday there. The coupon was fully transferable and could be resold for $2,000.

The benefit of the tour coupon, even though it was convertible into money, would not be charged to salaries tax at its second hand value of $2,000 (see paragraph 9 above). Rather, section 9(2A)(c) would operate to include the amount of $3,000 paid by Employer D as Mr. Wong's assessable income for the year of assessment 2003-04.

Example 5

(a) *In the year of assessment 2003-04, Mr. Ng took a 10-day business trip to Tokyo. Employer E paid the air ticket, accommodation and meal expenses in the total amount of $50,000 for the trip.*

The business trip to Tokyo was not a holiday journey. The amount of $50,000 paid by Employer E therefore was not in connection with a holiday journey and would not be included as Mr. Ng's assessable income. The in-between weekend days will not be regarded as a holiday journey.

(b) *Facts same as (a) but Mr. Ng went for sightseeing in 1 afternoon during the 10-day visit when he was free. The costs incurred in the total amount of $1,000 were reimbursed by Employer E.*

The sightseeing session can be regarded as being incidental to Mr. Ng's business trip. Therefore, the amount reimbursed will not be assessed to tax.

(c) *Facts same as (b) but Mrs. Ng travelled with him. She paid for her own air ticket and shared the hotel room with Mr. Ng at no extra charge. She also went for the half-day sightseeing tour and spent $1,000 which was also reimbursed by Employer E.*

Mrs. Ng's trip was for holiday purpose. Therefore, the sightseeing expenses of $1,000 incurred by her were assessable as Mr. Ng's income [section 9(1)(a) of the Ordinance]. As for the shared hotel room, since no extra charge was made for her accommodation, no assessable income in that respect will arise. If an extra charge were made by the hotel and reimbursed by Employer E, the additional outlay would be assessed to tax.

(d) *Facts same as (a) but Mr. Ng extended his stay in Tokyo for 2 days for sightseeing. Employer E paid additional accommodation and meal expenses in the amount of $5,000 for the extended stay by Mr. Ng.*

Section 9(6) defines a "holiday journey" as the part of the journey taken for holiday purposes where a journey is taken for holiday and other purposes. The amount of $5,000 paid by Employer E in connection with the part of the trip to Tokyo taken by Mr. Ng for holiday purposes would be included as his assessable income for the year of assessment 2003-04.

(e) *Facts same as (a) but Mr. Ng's wife and 2 children accompanied him to take the 10-day trip to Tokyo. Employer E was aware that Mr. Ng's wife and 2 children took the trip for holiday purposes. In fact, it approved the arrangement and paid additional air tickets, accommodation and meal expenses of $60,000 for their trip.*

The holiday journey taken by Mr. Ng's wife and 2 children was granted by virtue of Mr. Ng's employment. The amount of $60,000 paid by Employer E in connection with the holiday journey would be included as Mr. Ng's assessable income for the year of assessment 2003-04.

Example 6

In the year of assessment 2003-04, Mr. Lau took a 4-day business trip to the US to be followed by 3 days' vacation there. Employer F paid $80,000 to a travel company for the entire trip including air ticket, accommodation, meals, transportation, etc. The cost of the air ticket was estimated at $10,000.

The part of the journey relating to the vacation cannot be regarded as being incidental to the business trip. However, since the expenses relating to such part cannot be readily ascertained, an apportionment based on the holiday-days basis, excluding the cost of the air ticket, would be appropriate, i.e. ($80,000 - $10,000) x 3/7 = $30,000.

Example 7

In the year of assessment 2003-04, Employer G purchased a business class ticket for $30,000 for Mr. So to travel to Australia for business purposes. Mr. So exchanged the ticket for 2 economy class tickets and paid a sum of $4,000 to the airline company for the transaction. His wife travelled with him on one of the economy tickets.

The travel of Mr. So's wife is for holiday purposes and hence the amount paid by the employer attributable to her economy ticket will be included as Mr. So's assessable income. The chargeable amount is ($30,000 + $4,000)/2 - $4,000, i.e.$13,000.

Example 8

Mr. Leung went for a single business trip to Japan, Korea and Taiwan. He attended a meeting in Japan on Monday, had a stopover in Japan on Tuesday, and flew to Korea on Wednesday for a meeting. He had another stopover in Korea on Thursday and flew to Taiwan for a meeting on Friday. He returned to Hong Kong by Friday night.

The stopovers at Japan and Korea, comprising 2 days out of a 5-day journey, are not excessive in the circumstances. They are therefore accepted as being incidental to Mr. Leung's business trip and are hence not taxable.

Example 9

In the year of assessment 2003-04, Employer H purchased an air ticket for $10,000 for Mr. Chiu to travel to the US for business purposes. Mr. Chiu was given a certain mileage for the trip and he redeemed it for a free ticket to Tokyo for holiday.

The value of the free ticket to Tokyo is not assessable. No payment was made by the employer in connection therewith.

Example 10

In April 2003, Employer I organized a merit trip for all its staff to Malaysia in view of the company's record profits for the year ended 31 December 2002. A sum of $200,000 was paid to the organizing travel company. The staff were required to attend a half-day brain-storming session during the trip.

The primary purpose of the trip was for holiday as an award to the staff for the company's encouraging results for the past year. Therefore, the benefit has to be assessed on the individual employees, notwithstanding that they were required to attend the half-day brain-storming session, based on a head count basis.

Example 11

In the year of assessment 2003-04, Mr. Lam, a Singaporean, agreed to join Employer J, a Hong Kong company, as its financial controller for a term of 2 years. Employer J paid $30,000 to purchase air tickets for Mr. Lam, his wife and 2 children to relocate them from Singapore to Hong Kong.

In the year of assessment 2005-06, upon termination of Mr. Lam's employment, Employer J paid $40,000 to purchase air tickets for Mr. Lam and his wife and 2 children to relocate them from Hong Kong back to Singapore. They made a stopover visit of 2 days in Tokyo en route to Singapore.

The respective amounts of $30,000 and $40,000 were not paid in connection with a holiday journey and therefore would not be included as Mr. Lam's assessable income in either of the 2 years of assessment concerned. The stopover visit in Tokyo is disregarded as a concession.

TRANSITIONAL ARRANGEMENT

24. Since certain holiday journey benefits that accrued to an employee before 1 April 2003 would continue to be exempt despite the amendments made by the Revenue (No.2) Ordinance 2003, it is necessary to decide when the benefits are considered to have accrued. In deciding the date of accrual of a holiday journey benefit, the Department resorts to the date when the employee becomes entitled to claim payment thereof [section 11D(b) of the Ordinance].

25. There are 2 scenarios. First, an employee may be entitled under his contract of employment to a certain amount of holiday allowance prior to 1 April 2003 (whether accrued or paid, and whether on a monthly basis or as a lump sum). To the extent that this allowance has been spent on holiday (even if the expenditure occurred post-1 April 2003), this would still be exempt under the old rules.

26. Secondly, where an employee is entitled to claim a reimbursement of his leave passage, the question will rest on when the employee is entitled to make such a claim. Obviously, the employee must have incurred the expenditure before he is entitled to make a claim for reimbursement. Therefore, the Department takes the date on which the employee incurred the passage expenditure as the date on which the benefit accrued to him.

27. The date of incurring a passage expenditure may be taken as the date on which the employee has contracted to buy an air ticket, or to join a tour, etc. as evidenced by the payment of a deposit or downpayment therefor. Even in the absence of a deposit or downpayment, the employee may adduce other supporting evidence to establish that he has entered into a binding and irrevocable agreement to incur the expenditure in question. The date of actually paying for the ticket or tour (or the remaining balance thereof, as the case may be) is not relevant for such purpose.

TAX AVOIDANCE

28. The Department will generally act in accordance with the Practice Notes in relation to the taxation of holiday journey benefits. However, in cases where tax avoidance is involved or suspected, the Department would consider to raise assessments under section 61 or section 61A as appropriate so as to counteract the avoidance.