

TAXATION OF HOLIDAY JOURNEY BENEFITS

Wallace Ng [November 2003]

Hong Kong Inland Revenue Department (“IRD”) has issued in August 2003 the Departmental Interpretation and Practice Notes No. 41 (“DIPN 41”) giving guidance to general public on its latest policy of assessing holiday journey benefits received by employees working in Hong Kong.

Introduction

Prior to 1st April 2003, the value of any holiday warrant (or so-called passage allowance) granted by employer to employee would be exempt from salaries tax if the benefit was actually consumed by the employee for traveling purpose pursuant to section 9(1)(a)(i) to (iii) of the Inland Revenue Ordinance (“IRO”). The exemption was also extended to any transportation allowance granted to an employee in connection with the holiday warrant provided that it had been spent for the said purpose. However, the Financial Secretary of Hong Kong announced in his 2003/04 Budget Speech that the above exemption would be removed with effect from 1st April 2003.

Implication

General speaking, fringe benefit received by employee in connection with his or her employment will be subject to salaries tax if it satisfies the following conditions:-

1. the benefit is taken in the form of “money’s worth” (i.e. the benefit either is convertible into money by the employee or involves the discharge of a personal liability of the employee) – Section 9(2A)(a); or
2. the benefit involves payment by an employer in connection with the education of a child of the employee – Section 9(2A)(b).

The removal of the specific tax exemption clause for holiday warrant means that the benefit will be assessed in accordance with the above general tax principles. However, if there is a chance that the employer will arrange to convert a holiday warrant into an air ticket or a holiday tour and give it cost-free to his employee, the benefit received by the employee will remain not chargeable to tax because the benefit is neither convertible to money in the hands of the employee nor has the employer discharged the employee’s personal liability.

In order to plug the above loophole, the IRD also amended Section 9(2A) of the IRO by adding the following clause:-

“ any amount paid by an employer in connection with a holiday journey – S.9(2A)(c)”

The effect of the above amendments is to subject all payments by an employer in connection with a holiday journey to salaries tax in the hands of the employee, irrespective of whether or not it is convertible into cash and whether the primary liability for the benefit is vested on the employer.

BASIS OF CALCULATION

Generally speaking, the IRD can assess holiday journey either based on its market value or the cost incurred by the employer. However, having considered that it is sometimes difficult to assess the market value of a benefit, the IRD adopts the latter approach (i.e. to assess the benefit by reference to the cost incurred by the employer).

Although the amended tax principle looks simple at the first glance, its application could cause confusion in some complex situation. The IRD has set out in DIPN 41 various practical examples to explain the application of the new law. They are extracted in the Appendix for your easy reference.

TRANSITIONAL ARRANGEMENT

If the holiday journey benefits were accrued to an employee before 1st April 2003, it would continue to be exempted from tax despite of the above amendments. It is therefore important during the transitional period to decide when the benefits are considered to have accrued. Pursuant to DIPN 41, the Department considers that it should be the date when the employee becomes entitled to claim payment thereof.

Being an employee, there are two common situations that you may encounter:-

Situation	Tax Treatment
You are entitled under contract of employment to a certain amount of holiday allowance prior to 1 st April 2003 and this allowance has been spent on holiday.	No matter the allowance is accrued or paid, it is exempted from tax due to the fact that it was granted to you prior to 1 st April 2003.
You are entitled under contract of employment to claim a reimbursement of your leave passage. You incurred the expenditure prior to 1 st April 2003, but claim reimbursement after the above date.	Since you incurred the expenditure ^{Note} prior to 1 st April 2003, the reimbursement entitled by you would still be exempted from tax.

Note: It is taken as the date on which the employee has been entered into a binding and irrevocable agreement to incur the expenditure in question.

APPENDIX – CASE STUDIES EXTRACTED FROM DIPN 41

Scenario 1

Situation: In the year of assessment 2003/04, Employer A granted an allowance of HK\$30,000 to Mr. Chan for taking 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 HK\$10,000 for a holiday tour in July 2003 during his annual leave and pocketed the remaining HK\$20,000.

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

Scenario 2

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

Tax Implication: The amount of HK\$20,000 paid by Employer B to discharge Mr. Lee's personal liability will be included as Mr. Lee's assessable income for the year 2003/04. The position is not affected by the amendments made by the Revenue (No.2) Ordinance 2003.

Scenario 3

Situation: In the year of assessment 2003/04, Employer C paid HK\$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 purpose. The package tour could not be transferred to other persons. Employer C also paid HK\$3,000 to take out a family travel insurance policy for Mr. Ho.

Tax Implication: Although the package tour was not convertible into money, the total amount of HK\$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.

Scenario 4

Situation: In the year of assessment 2003/04, Employer D paid HK\$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 HK\$2,000.

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

Scenario 5

Situation: 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 HK\$50,000 for the trip.

Tax implication: The business trip to Tokyo was not a holiday journey. The amount of HK\$50,000 therefore is not connected with a holiday journey and will not be included as Mr. Ng's assessable income. The in-between weekend days also will not be regarded as a holiday journey.

Scenario 6

Situation: Facts same as scenario 6 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 HK\$1,000 were reimbursed by Employer E.

Tax Implication: 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.

Scenario 7

Situation: Facts same as scenario 6, 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 HK\$1,000 which was also fully reimbursed by Employer E.

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

Scenario 8

Situation: Facts same as scenario 5, 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 HK\$5,000 for his extended stay.

Tax Implication: Section 9(6) defines a “holiday journey” as that part of the journey taken for holiday purpose where a journey is taken for both holiday and other purposes. The amount of HK\$5,000 paid by Employer E in connection with the part of the trip to Tokyo taken by Mr. Ng for holiday purpose will be included as his assessable income for the year.

Scenario 9

Situation: Facts same as scenario 5 but Mr. Ng’s wife and the two children accompanied him to take the 10-day trip to Tokyo. Employer E was aware that Mr. Ng’s wife and the two children took the trip for holiday purpose. In fact, it approved the arrangement and paid additional air tickets, accommodation and meal expenses of HK\$60,000 for their trip.

Tax Implication: The holiday journey taken by Mr. Ng’s wife and the two children was granted by virtue of Mr. Ng’s employment. The amount of HK\$60,000 paid by Employer E in connection with the holiday journey will be included as Mr. Ng’s assessable income for the year.

Scenario 10

Situation: In the year of assessment 2003/04, Mr. Lau took a 4-day business trip to USA followed by 3 days’ vacation there. Employer F paid HK\$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 HK\$10,000.

Tax Implication: That part of the journey related to the vacation cannot be regarded as being incidental to the business trip. However, since the expenses of such part cannot be readily ascertained, an apportionment based on the holiday-days basis, excluding the cost of the air ticket, is to be made.
i.e. $(\text{HK\$}80,000 - \text{HK\$}10,000) \times 3/7 = \text{\$}30,000$.

Scenario 11

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

Tax Implication: The travel of Mr. So’s wife is for holiday purpose 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:
 $(\text{HK\$}30,000 + \text{HK\$}4,000)/2 - \text{HK\$}4,000$ (i.e. HK\$13,000).

Scenario 12

- Situation:** 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.
- Tax Implication:** The stopovers at Japan and Korea, comprising 2 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 the related expenses are not taxable in his hands.

Scenario 13

- Situation:** In the year of assessment 2003/04, Employer H purchased an air ticket of HK\$10,000 for Mr. Chiu to travel to USA for business purpose. Mr. Chiu was given a certain mileage for the trip and he redeemed it for a free ticket to Tokyo for holiday.
- Tax Implication:** The value of the free ticket to Tokyo is not taxable because the employer does not make any payment in connection therewith.

Scenario 14

- Situation:** In April 2003, Employer I organized a merit trip for its employees to Malaysia in view of the company's record profits for the year ended 31-12-2002. A sum of HK\$200,000 was paid to travel company. The staffs were required to attend a half-day brain storming session during the trip.
- Tax Implication:** The primary purpose of the trip was for holiday as an award to the staffs for achieving the encouraging business results last year. Therefore, the benefit has to be assessed on individual employees notwithstanding that they were required to attend the half-day brain storming session.

Scenario 15

- Situation:** In the year of assessment 2003/04, Mr. Lam, a Singaporean, agreed to join Employer J, a Hong Kong company, as financial controller for a term of 2 years. Employer J paid HK\$30,000 to purchase air tickets for him, 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 HK\$40,000 to purchase air tickets for him, 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.
- Tax Implication:** The respective amount of HK\$30,000 and HK\$40,000 were not paid in connection with a holiday journey and therefore will not be chargeable to salaries tax. The stopover visits in Tokyo is disregarded as a concession.