

ESC 9 Gratuities

Section 9 of the Taxes Ordinance defines the basis of assessment on the chargeable income of any person.

Section 9(1A), which was introduced on 1 January 2003, sets the time when income shall be treated as being “received and paid”. For employees, the date is based on the earlier of

1. The time when payment of, or on account of the income is actually made to the employee, or
2. The time when the employee becomes entitled to the income.

In many cases the terms and conditions set down in an officer’s contract mean that they are not entitled to any gratuity payment until the end of their contract. This is because they have to fulfil the conditions of that contract before they earn the right to the gratuity. Consequently, under the rules at section 9(1A) their gratuity payment falls chargeable to tax at the time it is paid, even though they may have earned the right to that payment over the whole period of their contract.

The Tax Office have operated a practice of comparing the tax consequence for contract officers’ gratuities of having them taxed in the year of receipt or spread over the term of the contract. Whichever method results in the recipient paying less tax has been applied. This treatment is jeopardised by section 9(1A) so for the purpose of clarification it is proposed that this concessionary practice continues.

Explanation

Under the statute, the general rule is that tax is charged on income **for** the year. Section 9(1A) now says that employment income is treated as being “received and paid” at either the date it is physically paid or when entitlement arises. This leads to the alternative interpretation that for means of, i.e. received in the year.

Entitlement to the gratuity does not arise until the contract is completed so that is when it is actually paid and consequently it all becomes taxable in that year.

Obviously FIG contracts are all fairly standard but independent businesses may have different terms and conditions for each contract officer they employ. Any claim to have this concession applied to their gratuities will be allowed subject to a check of the actual terms set down in their own contract.