

Hong Kong employment law update



In this update we write about three interesting recent Court decisions concerning:

- (a) resignations shortly before an employee's start date;
- (b) ramifications from the non-payment of wages; and
- (c) whether salaries tax is payable on bonus scheme shares issued to an ex-employee.

(a) Law Tin Pong Secondary School ("school") v Chen Wai Wah ("C") [2021] HKCA 873

In the above case the Court of Appeal ("**CA**") overturned a decision of the High Court, and restored a judgment from the Labour Tribunal.

Facts

Some details and comments about the case are set out in our 2019 update ([see](#)). In summary, the issue was whether or not a teacher, C, hired on 17 July 2017 to start work on 1 September 2017 could walk away from his obligations to report for work without serving his notice period of 3 months or making a payment in lieu of notice to the school.

On 17 July 2017 the school gave C: (i) an offer of employment where the period of employment was expressed as 1 September 2017 to 31 August 2018; (ii) Conditions of Service; and (iii) a letter of acceptance ("**Letter**") which provided once the offer was accepted on C signing and returning the Letter, a new employment contract would exist and C would then need to give 3 months' notice to terminate his employment. On the same day, C signed and returned to the school a copy of the Letter.

This dispute arose when C informed the school on 22 August 2017 that he would stay with his current employer (this is a scenario we come across frequently). C apologized for changing his mind and offered to pay the school its expenses to re-advertise his job. He refused to pay anything else.

A replacement for C was found quickly who started work on 5 September 2017. The school then sought 3 months' wages from C in lieu of him serving his notice period.

Lower Courts

The Labour Tribunal had little hesitation in granting the school's claim but the High Court found otherwise after strictly interpreting what comprised the employment contract and finding the Letter and its notice provisions had no contractual effect thereby allowing C to back out from the job with impunity.

CA

The CA disagreed and held that all three documents provided to C on 17 July 2017 formed the employment contract. The Letter was the only way C could accept the job offer and, viewing the circumstances as a whole, legal effect must be given to its contents, in particular the statement that once C accepted the offer a new employment contract would come into effect which included the obligation to give 3 months' notice of termination.

C also argued that him needing to make a payment in lieu of notice was a penalty clause and therefore unenforceable because the amount of the payment, HK\$139,593, was disproportionate to the school's losses: (i) C was due to commence work on 1 September 2017, his replacement started 4 days' later and until then

C's duties were performed by existing staff, so the school suffered no losses; and (ii) as C's replacement was a candidate known to the school and it did not incur any re-advertisement costs.

The CA held that the school's claim was for the recovery of a debt arising from a contractually agreed method for a lawful termination so the doctrine of penalties was not engaged.

Nonetheless, considering penalties thereafter, the CA held that the test to be applied to determine whether a clause was a penalty is:

"... whether the ... provision is a secondary obligation that imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation. ... compensation is not necessarily the only legitimate interest that the innocent party may have¹."

The CA found the school had a duty of care to its many students and it was important for it to have suitable, steady and a sufficient number of teachers on its staff at all times. A teacher's departure is highly disruptive to its students, so the school had a legitimate interest to enforce the performance of its employment contracts. Accordingly, the 3 months' notice period and the payment in lieu provisions weren't out of all proportion to the school's legitimate interests of maintaining a stable workforce in the face of problems and difficulties appointing replacements.

Conclusions

The CA's decision is in-line with the comments made at the end of our earlier update.

In our opinion this decision has general applicability.

The CA has therefore made abundantly clear that an employment contract comes into existence as soon as it is accepted and it is enforceable immediately thereafter even though time for its substantive performance would be in the future. So should an employee back out of a job shortly before their commencement date the employer concerned will in all likelihood be entitled to make a claim for a payment in lieu of notice of the employee serving their notice period.

(b) Official Receiver v Wong Ping Kuen ("W") [2021] HKEC 2635

W was a director of JV Fitness Limited ("J") between 15 December 2015 to 5 May 2016 when he resigned. Despite his resignation, W continued to act as de facto director and chief executive officer until 13 July 2016 when J went into liquidation.

As such, W was responsible for J's operations, financial affairs, decision making and was the sole signatory of its bank accounts. He therefore decided when J's employees' wages were paid.

In breach of the Employment Ordinance², W failed to make arrangements for J to pay 550 of J's employees their wages worth over HK\$17 million in total. W's failures resulted in him being criminally prosecuted by the Labour Department, which issued 101 summonses against him³.

W also: (i) failed to ensure the due payment of J's MPF contributions; (ii) allowed J to continue trading while insolvent selling the public memberships which J could not hope to fulfil; (iii) breached various record keeping provisions⁴; and (iv) repaid his own company the sum of HK\$10.2 million from J's funds in June 2015.

¹ Paragraph 32 of *Cavendish Square Holdings v Makdessi and Parking Eye Ltd. v Beavis* [2016] AC 1172, Lords Neuberger and Sumption.

It is also pointed out that: (i) the CA held that now adopted into Hong Kong law is this new English law test for whether a liquidated damages provision is an unenforceable penalty (i.e. the 'out of all proportion' test will apply instead of the old 'genuine pre-estimate of loss' test); and (ii) the new test now applies to all Hong Kong contract law and isn't confined to the narrow employment law field.

² Sections 23, 25(1), 63C and 64B(1).

³ W pleaded guilty and was fined HK\$202,000.

⁴ Breaching sections 619, 641 and 648 of the Companies Ordinance.

Based on the facts above, the Official Receiver felt W's conduct was so culpable it justified his disqualification from the management of any company to both punish him and to protect the public. The Court agreed and made a disqualification order against him preventing W from being involved in the management of a company for 2 years.

Conclusions

The Labour Department has a zero tolerance to the non-payment of wages. However, what was unusual here is that criminal liability for J's wages default was also passed to W because typically only the employer (i.e. the company) is prosecuted. Here the Labour Department was able to prove the default happened with W's consent or from his neglect. This case sends a strong message that directors are potentially criminally responsible for the timely payment of wages and significant breaches of such obligations may result in a disqualification order also being made.

(c) *Heath Brian Zarin ("H") v The Commissioner of Inland Revenue [2021] HKCU 3053*

H worked at a bank and appealed to the CA various assessments to salaries tax made on entitlements received by him from the bank's '*discretionary bonus scheme*'.

Facts

The bonus scheme provided for the payment of cash or shares or a mixture of the two. H's 2011 bonus was declared in March 2012 and comprised of shares to be vested as follows in March 2013 (33%), March 2014 (33%) and March 2015 (34%).

The relevant provisions of the bonus scheme stated: (i) H would receive such shares provided he remained in full-time employment at the time of vesting or, if he left the bank, he satisfied '*good leaver*' provisions on doing so; (ii) being made redundant qualified him as a good leaver; and (iii) awards could be reduced or cancelled before they vested.

H was made redundant in January 2013. Negotiation of a termination agreement ("**TA**") followed with the bank proposing to only release the un-vested shares to H if he agreed to assist with future litigation in Hong Kong and overseas concerning a particular investment of the bank's. H meanwhile made a data access request ("**DAR**") to the bank.

After 6 months, the parties then entered the TA whereby H agreed to withdraw his DAR and settle all of the claims he had. H also agreed to assist with any litigation. Thereafter, in 2014 and 2015 shares worth HK\$1,764,805 and HK\$1,579,820 respectively were released to him. The value of those share was assessed for salaries tax⁵ because their issue to him was found to be in consideration of H being the bank's employee or a reward for his past services and accordingly held to be income from H's employment.

In opposition to the tax assessment it was argued that: (i) H was not entitled to the shares when his employment ended; (ii) the discretionary bonus scheme was not part of his employment contract; (iii) the vesting of shares in 2014 and 2015 was in return for fresh consideration and undertakings provided in the TA; (iv) until the shares vested nothing of value was received; and (v) the TA was agreed 6 months after H's employment ended.

The CA held that under the TA the shares were released to procure H's long term assistance with the bank's litigation and on that basis were not from his employment and therefore were not taxable for salaries tax.

Conclusions

In our experience, whenever termination packages are discussed there are often questions about whether or not the payments to be made are going to be taxable. This case is a good example of where the boundaries of a salaries tax assessment lie.

⁵ Under section 8(1) of the Inland Revenue Ordinance as income (which under section 9(1) includes bonuses) from H's employment by the bank.

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