Case No. D14/85

Board of Review:

H. F. G. Hobson, *Chairman*, Ronald Arculli, C. G. Large, *Members.*

6 September 1985.

Salaries Tax—Section 8(1) and (1A) of the Inland Revenue Ordinance—sources of income—employee of Hong Kong Corporation residing in Hong Kong—duties partly performed outside Hong Kong—whether income arose in or derived from Hong Kong.

The Appellant worked previously for a multi-national group in the Pacific region. In 1980, he accepted the offer of a post from a member company of the group, which was a Hong Kong corporation. The Appellant's responsibilities covered Hong Kong and other overseas regions. He resided in Hong Kong with his family. His remuneration was paid by he employer in local currency. The Appellant was assessable to Salaries Tax on the whole of his income. He appealed on the ground that the proportion of his income related to overseas activities should be excluded from tax. It was argued on his behalf that the place where the activities were performed should be the correct test in determining the source of income under Section 8(1).

Held:

(1) There is a deliberate distinction between source rules applicable to profits and salaries.
(2) The Appellant was based in Hong Kong with contractual responsibilities to his Hong Kong employer; the activities conducted outside Hong Kong was part of his Hong Kong functions.
(3) The Appellant's income arose in or was derived from Hong Kong and was not subject to apportionment.

Appeal dismissed.

Luk Nai Man for the Commissioner of Inland Revenue.
A. A. Amador of A. A. Amador & Associates for the Appellant.

Reasons:

The issue in this appeal was whether Salaries Tax was exigible on the whole of the Taxpayer's income during the years of assessment 1981/82 and 1982/83 notwithstanding that much of the Taxpayer's working time was spent outside Hong Kong.

The Taxpayer, B, who gave evidence, was represented by Mr. A. A. Amador, Mr. LUK Nai-man Senior Assessor (Appeals) appeared for the Inland Revenue.

During the years with which we were concerned B was an employee of NCL, a company owned by SM International Ltd. of Bermuda and SM of U.S.A.: the ultimate holding company is however SMC of the Philippines.

B testified that he had worked for the SMC Group for 18 years in various locations in the Pacific. Immediately prior to his engagement with NCL he was based in Indonesia but during a periodic visit to SMC's headquarters in Manila in 1980 he was asked if he would be willing to work for NCL to which agreed. About a year later, by a letter dated 12 October 1981 ("October Letter") addressed to him in Jakarta NCL made a formal offer with detailed terms. Formal letters of appointments, B said, were a normal practice for SMC. Two points emerged from B's testimony concerning his engagement by NCL. The first was that he regarded his initial letter of engagement by SMC 18 years ago as still in existence. Secondly, and almost logically a corollary of the first, that the October Letter was a standard contract issued by all the non-Philippine based companies of the SMC Group and anyhow it was needed to obtain Hong Kong immigration clearance. We assume from these points, though it was not explicitly put to us, that B was suggesting that both he and of course NCL looked upon the October Letter as having no material significance. If indeed such an implication was intended then we have no hesitation in dismissing it because not only was the initial letter not produced to enable us to form a reasoned opinion, it is also incongruous with subsequent testimony that SMC is unable to make commitments outside the Philippines involving foreign currencies. Moreover accepting that there was an initial letter, nonetheless in the absence of sighting its terms we think it is reasonable to assume that it had been either superseded by intervening contracts or suspended so long as the latter were in force. In any case no one seriously contended before us that the October Letter was anything less than a genuine offer of employment and we therefore propose to treat it as the best evidence of B's contract of employment with NCL.

In response to an IRD enquiry, NCL furnished a description of B's job wherein the basic purpose is described as "to manage and profitably develop the Company's beer investment and activities in offshore beer operations". The appointment originally carried the title "Manager, Beer Operations" and though the title was subsequently changed there was no substantial change in related responsibilities. Those responsibilities were in line with the principal activities of NCL, that is to say an investment holding company involved in the manufacture and distribution of bottled, canned and draught beer in Hong Kong, Papua New Guinea and Indonesia. B however did say that NCL did not concern itself with the affairs of SMB in Hong Kong.

At the material time NCL had 12 subsidiaries, 6 in Hong Kong and 6 outside, 4 associates, 1 of which was a Hong Kong company, and 3 non-Hong Kong companies in which it held a small investment. The non-Hong Kong companies were variously incorporated in Papua New Guinea, Guam, Western Semoa and Malaysia.

For the moment that is sufficient introduction to the factual background.

Turning to legal issues the written grounds of appeal were confined to a submission that the Deputy Commissioner of Inland Revenue (DCIR) erred in applying that IRD guidelines in relation to the Totality of Facts approach. This approach is the method developed over the years through Board of Review decisions for determining the source of salaried income. (The phrase first appears in the published decisions at page 56). The Revenue have embraced that approach and in their extra-legislative guideline No. 10 have sought to particularize the ingredients. However Mr. Amador in his submissions to this Board went on to challenge the propriety of the Totality of Facts test, contending that the correct method for determining the source of income under section 8(1) is the place where the activities done pursuant to the contract of employment are performed; the contract of employment being a mere precursor to the active performance of the jobs done.

On the whole Mr. Amador's arguments in this regard are an echo of those put forward for the appellant in the CPA pilot's case B/R 14/75 and where they are examined comprehensively and with clarity. We interpret that decision as meaning that if the source of incomes is not located in Hong Kong, and hence outside the scope of s. 8(1), nevertheless by s. 8(1A)(*a*) a person who renders services here will be subject to salaries tax (unless his visit does not exceed 60 days in the basis period—s. 8(1B)). It follows from this that if the test of source for s. 8(1) was intended to be confined to localization of the services rendered then s. 8(1A)(*a*) would be entirely unnecessary. But the words "includes, without in any way limiting the meaning of the expression" (i.e. arising or derived from the Colony from any employment)—are quite obviously an extension rather than a confinement of s. 8(1).

Mr. Amador suggests that the consequence is that "an unfounded distinction is drawn" between the source rules applicable to profits and those for salaries. We do not accept that such a distinction is unfounded in the sense that legislature intended something different; we think the distinction is deliberate. Counsel for the Revenue in that case particularly noted that unlike Australia, Hong Kong did draw a distinction between contracts of service and contracts for services hence under our law the remuneration for the self-same job carried out outside Hong Kong under a contract of service could attract Salaries Tax whereas if carried out under a contract for services it might, depending on the circumstances, escape profits tax. Certainly no 60 days rule applies to circumscribe profits derived in Hong Kong, we cannot therefore see why it should be thought that different source systems are anomalous. The nature of the contract from which salaries are derived and that from which it is hoped profits will arise are so obviously different, at least in the eyes of the Common Law, as to need no further comment.

Save for the passing reference we have made, we do not propose to reiterate here the reasons for the decision given in B/R 14/75—where it would seem that a great deal more in-depth argument was aired, both for the Taxpayer and the Revenue—we would simply say that we can find no fault in its ratio decidendi and therefore, with a nod of gratitude. propose to adhere to it.

Mr. Amador referred us also to B/R Case No. 11/82 which on the factual side we concerned with whether or not the Taxpayer's two contracts of employment were essentially

one contract. Mr. Amador took issue with the words "a single indivisible contract of employment" in the following passage:

> "… that the place where services are rendered or work is done are the critical factors in deciding source for Profits Tax and that a similar approach should be adopted for Salaries Tax. In theory we would agree but there is, in our view, a fundamental distinction between a business which earns profits from a series of separate contracts and an employment which earns income from a single indivisible contract of employment. In reaching its conclusions in the above two Profits Tax cases the Supreme Court was faced with contracts which had both Hong Kong and offshore elements but was forced to decide on which side of the boundary the profits arose and in doing so looked into the locality where they arose as being determined by the considerations which fastened upon the acts more immediately responsible for the receipt of profits (c.t. C.T. (NSW) v. Hillsdon Watts Ltd. (1936) 57 CLR 36 at 51) …" (emphasis supplied)

We were puzzled as to the precise bearing his contention that the first quoted words are incorrect has upon B's case. Mr. Amador then proceeded to say that the work done pursuant to the contract of employment is capable of being divided. Granted, but it is not a necessary corollary that the contract itself if divisible. In any case we do not think that the Board was laying down as a matter of legal principal that contracts of employment can never be divisible, the Board in our view simply resorted to that phrase to point up the distinction between contracts of profits and those of employment. If Mr. Amador was suggesting that a contract of service can be chopped up into the jobs done pursuant to it to give each the characteristic of a contract for services, thereby bolstering his case that logic requires the same tax treatment, then we reject the suggestion for the reasons already stated. On the other hand perhaps he intended to show that the income under a contract of service is capable of severance—in which case we would agree and quote from the final paragraph of paragraph 13 of the Board of Review case D. 11/82 (page 19 of Vol. 2) viz. "Where, however, income from employment stems mainly from offshore based activities all the income would escape Salaries Tax where it not for s. 8(1A)(*a*) which by implication authorizes an apportionment on a time in time out or other appropriate basis in order to separate out the taxable proportion of total remuneration received for rendering services in Hong Kong". (Whilst agreeing, as mentioned at p. 203 of the published decisions, that "apportionment" is a misnomer, it helpfully encapsulates the consequences of s. 8 (1A)(*a*)).

Useful though the Revenue's guidelines as to the Totality of Facts may be, detailed analysis under any or all given heads need not be slavishly followed in order to reach a conclusion: to do so in some cases could result in missing the wood for the trees.

In this instance, without attempting to fit any of our conclusions under any given head we find as follows. B and his family resided in Hong Kong, NCL paid for the school fees of his children and Hong Kong was his base. He was paid in Hong Kong in the local currency by his employer, a Hong Kong corporation. It is against that corporation that he could have enforced the terms of service offered by the Employment Letter and though it is suggested that the conversation in Manila in 1980 gave rise to a contract under the laws of the Philippines no evidence was led to support that suggestion but if such were the case we can

only surmise that it would have been superseded by the October Letter. His contractual responsibilities were to NCL; thus if he was asked to do something in Hong Kong which was illegal here though not so under the laws of say Papua New Guinea or Guam, he could rightly have refused and if sacked therefor he could sue NCL. In his job description he was answerable to the Managing Director of NCL: that the Taxpayer also reported to SMC is understandable and may even have been a requirement of NCL but such reporting was not an activity unrelated to the performance of his functions with NCL. The activities he conducted outside Hong Kong were in furtherance of plans, supervised, monitored and perhaps even conceived in and from Hong Kong. Undoubtedly those activities were intended to benefit the subsidiaries concerned but by the same token NCL hoped to benefit. These activities were part and parcel of his Hong Kong functions. NCL was deliberately created as a quasi-autonomous holding company for certain Far East activities. We therefore think that NCL is the logical entity to which the funding of the Taxpayer's salary should be attributed. The subsidiaries do not fit the bill since according to NCL no part of his salary was reallocated to them: SMC is out of the picture since it could not make commitments in foreign currencies. In the light of the above we are firmly of the opinion that Mr. Ottiger's income for the years concerned arose in or was derived from Hong Kong. Consequently this appeal is dismissed and the assessments are hereby confirmed.