INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D178/98

Salaries Tax – whether income subject to profits tax or salaries tax –sections 8, 9, 12(1)(a), 14, 68(4) of the Inland Revenue Ordinance.

Panel: Terence Tai Chun To (chairman), Raphael Chan Cheuk Yuen and Charles Chiu Chung Yee.

Dates of hearing: 24 November 1998 and 26 January 1999.
Date of decision: 23 March 1999.

The taxpayer is an artist in the publication industry and has entered into a contract with a company ('the Company') for a period of 6 years from 1987 to 1993. The contract provides that, *inter alia*, the Company is to provide the taxpayer with the necessary basic equipment and facilities and assistants, flexible working hours and the taxpayer remuneration is determined by the number and type of manuscripts drawn, etc.

For the first 4½ years, the taxpayer was content with his status as an employee of the Company. In November 1991, the Taxpayer formed Company D as sole proprietor. For the years of assessment of 1991/92 and 1992/93, he claimed for assessment on the basis of profits tax, claiming deduction for expenses including rental and wages for staff. The income he received from the Company was included in the assessable profits claimed for Company D.

The taxpayer appeals against the Commissioner's assessment of his income for the years of assessment 1991/92 and 1992/93 on the basis of salaries tax instead of profits tax.

Held:

(1) Flexible office hours were not uncommon in a contract of service. The presence or absence of matters such as probation period, annual leave, passage allowance, sick leave, pension entitlement and accommodation in a contractual relationship can only be a neutral factor which does not determine the particular nature of the contract.

(2) Whether the taxpayer received any bonus was entirely at the discretion of the Company and as such there was no profit sharing between the taxpayer and the Company.

(3) The taxpayer failed to show that the deduction of expenses claimed under section 12(1)(a) of the IRO was wholly, exclusively and necessarily incurred in the production of the assessable income.

(4) The taxpayer was at all material times an employee of the Company and as such would be liable for salaries tax.

Appeal dismissed.

Cases referred to:

Hall v Lorimer (1994) STC 23
Walls v Sinnett (Inspector of Taxes)(1986) STC 236
Market Investigations v Minister of Social Security (1969) 2 QB 173

Fung Ka Leung for the Commissioner of Inland Revenue.
Ryan Ip Ho Chuen of Messrs Ryan Ip & Co for the taxpayer.

Decision:

1. Mr A (the Taxpayer) appealed against a determination of the Commissioner relating to salaries tax assessments for the years of assessment 1991/92 and 1992/93. The Taxpayer claims that his income should be subject to profits tax and not to salaries tax.

The law

2.1 Section 8 of the Inland Revenue Ordinance ['the IRO']

'(1) Salaries tax shall, subject to the provisions of this Ordinance, be charged … on every person in respect of his income … from the following sources –

(a) any office or employment of profits; and …'

2.2 Section 9 of the IRO

'(1) Income from any office or employment includes –

(a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance …'

2.3 Section 12(1)(a) of the IRO

'all outgoins and expenses, other than expenses of a domestic or private nature and capital expenditure, wholly, exclusively and necessarily incurred in the production of the assessable income;'

2.4 Section 14 of the IRO

'Subject to the provisions of this Ordinance, profits tax shall be charged … on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits … from such trade, profession or business …'

2.5 Section 68(4) of the IRO

For hearing and disposal of appeals to the Board of Review,

'(4) The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'

2.6 Hall v Lorimer (1994) STC 23

'In order to decide whether a person carries on business on his own account it is necessary to consider many different aspects of that person's work activity. This is not a mechanical exercise of running through items on a check list to see whether they are present in, or absent from, a given situation. The object of the exercise is to paint a picture from the accumulation of detail. The overall effect can only be appreciated by standing back from the detailed picture which has been painted, by viewing it from a distance and by making an informed, considered, qualitative appreciation of the whole. It is a matter of evaluation of the overall effect of the detail, which is not necessarily the same as the sum total of the individual details. Not all details are of equal weight or importance in any given situation. The details may also vary in importance from one situation to another. The process involves painting a picture in each individual case. As Vinelott J said in Walls v Sinnett (Inspector of Taxes) (1986) STC 236 at 245: "It is, in my judgment, impossible in a field where a very large number of factors have to be weighed to gain any real assistance by looking at the facts of another case and comparing them one by one to see what facts are common, what are different and what particular weight was given by another tribunal to the common facts. The facts as a whole must be looked at, and a factor which may be compelling in one case in the light of the facts of that case may not be compelling in the context of another case."'

2.7 Market Investigations v Minister of Social Security (1969) 2 QB 173

> *'Is this person who has engaged himself to perform these services performing them as a person in business on his own account? If the answer to that question is "Yes", then the contract is a contract for services. If the answer is "no" the contract is a contract of service. No exhaustive list has been compiled … whether the man performing the service provides his own equipment, whether he hires his own helpers, what degree of financial risk he takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task.'*

3. The Taxpayer was represented by Mr Ryan Ip of Ryan Ip & Co, certified public accountants.

4. The Taxpayer gave evidence at the hearing. Three other witnesses were called to give evidence on behalf of the Taxpayer.

5. No witnesses were called to give evidence on behalf of the Commissioner.

6. Before the Board, there were the following bundles of documents, namely:

(1) the Board's Bundle which included the Commissioner's determination,

(2) The Revenue's Bundle,

(3) The Taxpayer's Bundle.

7. We find the following facts.

8. The Taxpayer was an artist in the publication industry.

9. In 1987, he entered into a written contract with Company B for a period of 6 years commencing from 8 March 1987.

10. On 6 July 1993 Company B was re-named Company C.

11. Company B or Company C will in the course of this decision be referred to as the Company.

12. For the sake of completeness, an English translation of the written contract is reproduced below:

' **Translation**

Appointment Contract

This is a contract made between:

Party A: Company B

Party B: Mr A

Both parties agree on the following terms and condition:

1. Party A employs Party B to draw _____ and any other drawing specified by Party A for a period of six years.

2. This contract shall run between 8-3-1987 and 7-3-1993.

3. During the contract, Party B shall work full-time for Party A. Without the prior consent of Party A, Party B is not allowed to provide manuscript or provide other service or work part-time for any other companies or himself.

4. Any copyrighter similar that may subsist in any manuscript or masterpiece produced by Party B for Party A shall be owned by Party A. Upon expiry of this Contract, Party B shall not continue to draw any manuscript under such copyright for any company or for his sole proprietorship as to destroy the copyright of the figures or content drawn by Party B for Party A under this Contract.

5. All the drawing produced by Party B shall be vetted by Party A who will have full authority to decide which to publish. If the content of the drawing violates Hong Kong Legislation or ethics or blasphemous or is of poor quality, then Party A shall have the right not to publish it and therefore under no duty to pay manuscript fee for those drawings.

6. Party B shall have to observe the guideline for painters laid down by Party A and to take advice and interactions with regard to work from Party A.

7. In case of unco-operation, neglect of work, or other action as to affect the publication of Party A or to cause disrepute to Party A or damages to the interest of Party A, Party A may terminate this contract without compensation and may sue Party B for damages through civil action.

8. All production produced by Party B during the period of the contract belonged to Party A. Unless with the prior consent of Party A, Party B shall not take anything from Party A outside the work area, otherwise Party A can call the police for investigation and to rescind this contract without any compensation to Party B.

9. The manuscript fee for Party B is enumerated on the basis of HK$100 per piece of 13" × 20". Increase in manuscript fee shall be 10% per year. For the sake of precise calculation of manuscript fee, both parties agree to use the size of the present manuscript _____currently used by Party B as the basis for calculation.

10. For determination of the loss to Party A, both parties agree that if Party B failed to draw _____ or other sketch of drawing for Party A on schedule as to affect the publication on time by Party A, Party B shall compensate Party A for all losses. The losses shall be computed on the basis of the net profit derived from sales of the publication as claimed by Party A.

11. Party B shall not disclose any commercial secret document or information of Party A to any companies or people.

12. If either party breach any part of this contract, he shall pay compensation to the other party.

13. If any party wants to terminate this contract, he shall have to give one year's notice to the other party.

Remarks:

(SD) Party A: illegible
Party B: Mr A
Witness: illegible
Date 8-3-1987'

13. The Taxpayer's principal duties were to draw for and as directed by the Company.

14. He was to work full time for the Company.

15. Without the consent of the Company, the Taxpayer was not allowed to provide manuscripts for other companies or take on part time work.

16. The Company was to provide the Taxpayer with the necessary basic equipment and facilities and assistants for the performance of the Taxpayer's duties.

17. The Taxpayer was to be responsible to the production controller of the artwork division.

18. As chief artist, the Taxpayer was responsible for the artwork of the publication as well as writing columns.

19. The Taxpayer was allowed to keep flexible working hours and as long as he could complete his work on schedule there were no minimum working hours for the Taxpayer.

20. The Taxpayer's remuneration was to be determined by the number of manuscripts drawn and the unit rate depended on the type of publication.

21. The Taxpayer also received a basic salary of $5,000.

22. In addition, the Taxpayer would receive a bonus based on the amount of contribution made by him but such bonus was entirely at the discretion of the Company.

23. All money paid by the Company to the Taxpayer was made by auto-pay to the Taxpayer's account or by cheques drawn in favour of the Taxpayer.

24. As it was the case with all the Company's employees, the Taxpayer was free to join the Company's provident fund scheme.

25. The Taxpayer did join the Company's provident fund scheme.

26. The Taxpayer also held himself out in no uncertain terms to be an employee of the Company when he bid farewell to his readers in a publication.

27. During the contract period of 6 years, that is, between 1987 to 1993, the Company filed employer's returns showing that the Taxpayer was its employee.

28. The Taxpayer was content with his status as an employee of the Company for the first 4½ years of the written contract.

29. For the years of assessments 1991/92, the Taxpayer decided for the first time that he should be treated as carrying on business on his own account.

30. In November 1991, the Taxpayer contrived the formation of Company D and declared himself to be the sole proprietor. He then treated his income from the Company as if it were income of Company D and went about claiming deductions of expenses for the period between 15 October 1991 and 31 March 1992 during the year of assessment 1991/92 as well as for the entire year of assessment 1992/93.

31. The Taxpayer enlisted the help of an accountant Madam E, herself an employee of the Company, to prepare the accounts of Company D.

32. In his profits tax returns for the years of assessment 1991/92 and 1992/93, the Taxpayer included in the assessable profits of Company D his income received from the Company.

33. For the accounts commencing from 15 October 1991 to 31 March 1992, that is, for a period of 5½ months, rental and other expenses for 12 months were claimed in the accounts and 13 months' wages were said to have been paid to one particular employee. This was blatantly excessive.

34. Apart from this obvious inaccuracy in the accounts, the Taxpayer was not in a position to produce receipts and vouchers to substantiate the outgoings and expenses claimed in respect of the years of assessment 1991/92 and 1992/93.

35. Madam E said that the receipts and vouchers had been lost though she had sight of them when she prepared the accounts.

36. Two other witnesses were called to testify that they had worked for the Taxpayer on a free lance basis and received remuneration.

37. According to these two witnesses, it was usual for a chief artist to employ his own assistants to help him on a free lance basis but it was not an invariable practice and each case would depend on its own circumstances.

38. The Taxpayer did not ask the Company for more assistants and the Company did not know that the Taxpayer employed his own assistants.

39. It would be interesting to note that:

(i) these two witnesses were full time employees of the Company;

(ii) neither of the witnesses could recollect the amount of remuneration received;

(iii) neither witness had heard of Company D and

(iv) the Company was not aware of the existence of Company D.

40. The Taxpayer admitted that Company D and Company F shared the same office premises and that some of the expenses of Company F were included in Company D's accounts.

41. Company F was set up to explore the China market.

42. The Taxpayer maintained that he was not an employee of the Company.

43. His main arguments were:

(i) He did not have to abide by regular office hours.

(ii) He employed his own assistants to draw for him and got his own equipment as it was the practice of the publication industry.

(iii) He had no probation period, annual leave, passage allowance, sick leave, pension entitlement, accommodation as would be expected to be included in a genuine employer-employee contract.

(iv) He was engaged in a profit sharing agreement with the Company. The Taxpayer worked on his own and would suffer loss if the Company refused to publish his manuscripts.

(v) As his reward depended on his contribution, it was in the Taxpayer's interest to employ free lance artists to help him produce good quality stuff to enhance popularity and sale.

44. We do not agree that the Taxpayer's arguments necessarily led to the conclusion that he was performing services as a person in business on his own account.

45. Flexible office hours were not uncommon in a contract of service.

46. The Taxpayer's representative postulated that matters such as probation period, annual leave, passage allowance, sick leave, pension entitlement, accommodation were normally included in a contract of service. But one might equally postulate that such matters were also normally found in a contract for service. The presence or absence of such matters in a contractual relationship can only be a neutral factor which does not determine the particular nature of the contract.

47. As canvassed by the Taxpayer, he was engaged in a profit sharing agreement with the Company. We do not find this was the case.

48. The Taxpayer's remuneration depended on the number of manuscripts drawn by him and published by the Company, and his bonus, depending as it did on his contribution, was entirely at the discretion of the Company. There was no profit sharing.

49. It was the contention of the Taxpayer's representative that if the Company exercised its right not to publish the Taxpayer's manuscripts if their contents would violate Hong Kong laws or ethical standards or be blasphemous or of poor quality the Taxpayer would incur a substantial reduction of income. It might well be so but to say that the Taxpayer in these circumstances risked losing his capital was farfetched and untenable.

50. The Taxpayer relied a good deal on the accepted practice of the publication industry to the effect that a chief artist employed his own assistants.

51. The evidence of the witnesses called by the Taxpayer showed that it was not the invariable practice for chief artists to employ their own assistants.

52. In the present case, the Company was obliged to provide the Taxpayer with assistants and it was not necessary for the Taxpayer to expend money to engage his own assistants.

53. From the totality of facts before us, we find that the Taxpayer was at all material times an employee of the Company and as such he would be liable for salaries tax.

54. As to deduction of expenses under section 12(1)(a) of the IRO, we find that the Taxpayer failed miserably to show they were wholly, exclusively and necessarily incurred in the production of the assessable income for the following reasons:

(a) No receipts or vouchers were produced to substantiate the various items of expenditure.

(b) The assistants, said to be employed by the Taxpayer to help him on a free lance basis did not recall the amount of remuneration received by them.

(c) The Taxpayer was not obliged to incur expenses in the employment of assistants or in the provision of equipment. Such expenditure was purely gratuitous.

(d) Company D and Company F shared the same office premises and some of the staff of Company D also worked for Company F.

(e) The accuracy of the accounts of Company D was shown to be questionable. Twelve months' rental and other outgoings as well as thirteen months' salary for one employee were claimed as expenses for the year of assessment 1991/92 covering a period of only 5½ months, that is, from 15 October 1991 to 31 March 1992. Further some of Company F's expenses such as salaries, electricity and water charges were included in Company D's accounts.

55. In view of all the circumstances, we find that the Taxpayer has failed to discharge its onus and we would dismiss the appeal accordingly.