Case No. D25/02

Salaries tax – location and source of employment – whether all the services are rendered outside Hong Kong – no provision for apportionment under the Inland Revenue Ordinance ('IRO') – artificial employment – whether the impugned transaction is commercially unrealistic – 'visits' – imposition of additional salaries tax assessments – sections 8(1), 8(1B), 61 and 68(4) of the IRO.

Panel: Kenneth Kwok Hing Wai SC (chairman), Vincent Lo Wing Sang and David Yip Sai On.

Date of hearing: 12 April 2002.
Date of decision: 8 July 2002.

This was an appeal by the appellant against the additional salaries tax assessment for the year of assessment 1998/99 raised on him.

The appellant claimed that his income from Listco, in which he was the chairman and an executive director in the year of assessment 1998/99, was not chargeable to salaries tax as he rendered all the services outside Hong Kong.

At the material times, Listco was a company incorporated in Country A and its shares were listed on The Stock Exchange of Hong Kong Limited. Its head office and principal place of business was in Kowloon.

The appellant confirmed that he did not pay income tax to the tax authority in Mainland China in the year of assessment 1998/99 as he had worked in the Mainland for less than 90 days.

The facts appear sufficiently in the following judgment.

Held:

1. The Board found that the location and source of the appellant's employment by Listco was in Hong Kong. His entire income from the employment by Listco was caught by the charge under section 8(1) of the IRO, and there was no provision for apportionment, CIR v Geopfert (1987) 2 HKTC 210 at page 238. The factors for saying so are:

    (a) The head office and principal place of business of Listco was in Kowloon.

(b) The appellant's employment contract was approved by Listco's directors at a board meeting held on 23 March 1998 at its address in Kowloon.

(c) Listco's address in Kowloon was stated in the employment contract dated 'the First day of 1st April 1998' [*sic*] as Listco's address.

(d) The appellant was identified in the employment contract by his Hong Kong identity card number.

(e) Clause 6 provided for payment of salary in Hong Kong dollars.

(f) Clause 8 provided for summary dismissal 'under the laws of Hong Kong'.

(g) Clause 10 provided that the laws of Hong Kong shall be the governing law.

2. What the Board was concerned with under section 8(1B) was 'visits not exceeding a total of 60 days'. In the relevant year of assessment, the appellant had been in Hong Kong in excess of 60 days.

3. In CIR v So Chak Kwong, Jack 2 HKTC 174, it was held that the words 'not exceeding a total of 60 days' in section 8(1B) qualify the word 'visits' and not the words 'services rendered'. Thus, section 8(1B) was not applicable in this case because the appellant's 'visits' exceeded 60 days, assuming that his trips to and from Hong Kong were 'visits'.

4. The appellant asserted that he rendered all the services in connection with his employment by Listco outside Hong Kong. The Board rejected his assertion and found against him on this factual issue.

5. The employment of the appellant by Listco was artificial. It was commercially unrealistic. Even if the appellant had, contrary to the Board's decision, succeeded on the source of employment and on the issue of whether all the services were rendered outside Hong Kong, the Board would have found against the appellant under section 61.

(a) The appellant was the chairman and executive director of Listco.

(b) The head office and principal place of business of Listco was in Hong Kong.

(c) Listco was listed in Hong Kong.

(d) The appellant rendered part of his services in Hong Kong and part of his services outside Hong Kong.

(e) In the circumstances, it was clearly artificial for the appellant to be employed and remunerated only for those part of his services rendered outside Hong Kong as 'China Consultant'.

(f) The only reason for the appellant not to be employed and not to be remunerated for those part of his services rendered in Hong Kong as chairman and executive director was to reduce the appellant's tax liability in Hong Kong.

6. The appellant had failed on all points. Clearly he had not discharged the onus under section 68(4) of proving that the assessment appealed against was excessive or incorrect.

Appeal dismissed.

Cases referred to:

CIR v Geopfert (1987) 2 HKTC 210
CIR v So Chak Kwong, Jack 2 HKTC 174
D29/89, IRBRD, vol 4, 340
D130/99, IRBRD, vol 15, 21
D77/99, IRBRD, vol 14, 528
D32/94, IRBRD, vol 9, 97
Seramco Trustees v Income Tax Commissioner [1977] AC 287
Commissioner of Inland Revenue v D H Howe [1977] HKLR 436

Fung Ka Leung for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal against the determination of the Commissioner of Inland Revenue dated 18 December 2001 whereby the additional salaries tax assessment for the year of assessment 1998/99 under charge number 9-1355760-99-6, dated 29 October 1999, showing additional net chargeable income of $860,000 with additional tax payable of $129,000 was confirmed.

The admitted facts

2. The following facts were admitted by the Appellant and we find them as facts.

3. The Appellant has objected to the additional salaries tax assessment for the year of assessment 1998/99 raised on him. The appellant claimed that his income from Listco was not chargeable to salaries tax as he rendered all the services outside Hong Kong.

4. Listco is a company incorporated in Country A and its shares are listed on The Stock Exchange of Hong Kong Limited. Its head office and principal place of business is in Kowloon.

5. Subsidiary and Associated, both incorporated in Hong Kong, are respectively subsidiary and associated company of Listco.

6. In the year of assessment 1998/99, the Appellant was the chairman and an executive director of Listco.

7. Listco, Subsidiary and Associated filed employer's returns in respect of the Appellant for the year of assessment 1998/99 showing the following particulars:

	Listco	**Subsidiary**	**Associated**
Capacity in which employed	China consultant	Managing director	Managing director
Period covered	1-4-1998 – 31-3-1999	1-4-1998 – 31-3-1999	1-4-1998 – 31-3-1999
	$	$	$
Salary	360,000	1,484,004	34,200
Bonus	500,000	2,150,000	5,700
	860,000	3,634,004	39,900

8. (a) The Appellant declared his employment income in the tax return for the year of assessment 1998/99 as follows:

		$
Subsidiary	Salary and bonus	3,634,004
Associated	Salary and bonus	39,900
A securities company	Consultancy fee	453,771
		4,127,675

(b) In a note to the return, the Appellant declared that he received salary and bonus of $860,000 from Listco for the year of assessment 1998/99. The Appellant stated that as a China consultant of Listco, he carried out his duties solely in Mainland China. He listed his days in Mainland China as follows:

1998	
April	5, 18, 22
May	-
June	23, 27, 28
July	1, 2, 12, 13, 31
August	1, 2, 12, 13, 14, 19, 20, 27
September	3, 11, 12, 17
October	13, 14
November	10, 11, 14, 15, 17, 18, 25, 26
December	8, 12, 13, 29, 30, 31
1999	
January	12, 13, 21
February	10, 11
March	3, 10, 11, 23

9. Subject to review, the assessor raised on the Appellant the following salaries tax assessment for the year of assessment 1998/99:

Income from	$
Subsidiary	3,634,004
Associated	39,900
A securities company	453,771
Net chargeable income	4,127,675
Tax payable	619,151

10. In reply to the enquiries raised by the assessor, Listco provided the following information relating to the Appellant's employment income for the year of assessment 1998/99:

(a) '(T)he company's investments in China grew much bigger with the start of the die-cast business in 1997. In light of the expanded business in China, the board decided that the company must put more emphasis on the China operations. Therefore, the board decided to revise the employment of [the Appellant] and to request him to work in China more often in order to assist and advise on the new operations'.

(b) The Appellant was required to work in Mainland China every month and/or on a project by project basis. He was required to manage, review and monitor the general affairs and the overall operations of Listco's subsidiaries and factories located in Mainland China.

(c) The Appellant was required to attend and hold meetings with staff in Mainland China and with local officials; perform physical review on source documents; monitor production work and capital projects; give advice to operations in Mainland China; and undertake such further duties as may deem appropriate from time to time.

(d) The Appellant was required to report to the board of directors by way of meeting notes, verbal meetings and minutes etc.

11. Listco provided copies of the notes of meetings showing that the Appellant had chaired meetings at the following three subsidiaries of Listco in Mainland China during the year:

(a) A subsidiary company at the first address in China.

(b) Another subsidiary company at the first address in China.

(c) A third subsidiary company at the second address in China.

12. The assessor considered that the Appellant's income from Listco was assessable to salaries tax and raised on the Appellant the following additional salaries tax assessment for the year of assessment 1998/99:

	$
Additional net chargeable income [paragraph 7]	860,000
Additional tax payable	129,000

13. The Appellant objected against the additional salaries tax assessment. He claimed that as a China consultant of Listco, he was required to give advice on the operations of foreign investment enterprises and factories in Mainland China. These entities were separate legal entities and the work could only be performed by him in Mainland China. He considered that the source of his income was from work performed outside Hong Kong and thus the income should be exempt from salaries tax.

14. As regards his reporting of work to the board of directors in Hong Kong [paragraph 10(d)], the Appellant stated that:

> 'As a China Consultant of [Listco], I need to perform all my operational duties outside Hong Kong. The reporting duties ... should be seen as an administrative part of my job that was performed in China.
>
> Since I work alone in China with no supervision, it is reasonable for the employer to get these types of administrative reports in order to appraise my performance. I do

not see the reason for treating the reporting duties as a kind of services to the Company in Hong Kong that would affect my objection.'

15. The Appellant confirmed that he did not pay income tax to the tax authority in Mainland China in the year of assessment 1998/99 as he had worked in the Mainland for less than 90 days.

The appeal

16. The objection having failed, the Appellant gave notice of appeal by letter dated 9 January 2002, appealing on the grounds that (written exactly as it stands in the original):

'1. Section 8(1A)(b)(ii) applies to services rendered by a person outside Hong Kong. It is clear from my previous objections that all my services were rendered physically outside Hong Kong.

2. The key point in the determination is that [As the Taxpayer performed his reporting duties in Hong Kong, he cannot be regarded as rendering all his services in connection with his employment outside Hong Kong (Part (4) of the Reasons Therefor in the Determination).]

3. The "Reasoning" in the determination is not correct because all the reports to the Company were minutes [Fact(9) of the determination] that were prepared and typed by subsidiaries of the Company in China. These documents were then sent to the Company by post/fax directly by the subsidiaries. The determination wrongly assumed that I carried out these reporting duties in Hong Kong. These documents actually show and confirm my work in China.

4. For the above reasons, Section 8(1A)(b)(ii) should apply because all my services were rendered outside Hong Kong and I should be exempted from my income derived outside Hong Kong ...'

17. By letter dated 4 March 2002, the assessor gave notice to the Appellant of the Respondent's intention to invoke section 61 of the IRO.

18. At the hearing of the appeal, the Appellant appeared in person and the Respondent was represented by Mr Fung Ka-leung, assessor.

19. The Appellant confirmed his case on oath and was cross-examined by Mr Fung Ka-leung. Mr Fung Ka-leung did not call any witness.

20. No authority was cited by the Appellant. Mr Fung Ka-leung cited:

(a) CIR v Geopfert (1987) 2 HKTC 210

(b) CIR v So Chak Kwong, Jack 2 HKTC 174

(c) D29/89, IRBRD, vol 4, 340

(d) D130/99, IRBRD, vol 15, 21

(e) D77/99, IRBRD, vol 14, 528

(f) D32/94, IRBRD, vol 9, 97

Our decision

Source of employment by Listco

21. Section 8(1), (1A) and (1B) of the IRO provides that:

'(1) Salaries tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from the following sources –

(a) any office or employment of profit ...

(1A) For the purposes of this Part, income arising in or derived from Hong Kong from any employment –

(a) ...

(b) excludes income derived from services rendered by a person who –

(i) ...

(ii) renders outside Hong Kong all the services in connection with his employment ...

(1B) In determining whether or not all services are rendered outside Hong Kong for the purposes of subsection (1A) no account shall be taken of services rendered in Hong Kong during visits not exceeding a total of 60 days in the basis period for the year of assessment.'

22. In our decision, the location and source of the Appellant's employment by Listco was in Hong Kong. His entire income from the employment by Listco is caught by the charge under section 8(1) of the IRO, and there is no provision for apportionment, CIR v Goepfert (1987) 2 HKTC 210 at page 238.

(a) The head office and principal place of business of Listco is in Kowloon.

(b) The Appellant's employment contract was approved by Listco's directors at a board meeting held on 23 March 1998 at its address in Kowloon.

(c) Listco's address in Kowloon was stated in the employment contract dated 'the First day of 1st April 1998' [*sic*] as Listco's address.

(d) The Appellant was identified in the employment contract by his Hong Kong identity card number.

(e) Clause 6 provides for payment of salary in Hong Kong dollars.

(f) Clause 8 provides for summary dismissal 'under the laws of Hong Kong'.

(g) Clause 10 provides that the laws of Hong Kong shall be the governing law.

23. What we are concerned with under section 8(1B) are 'visits not exceeding a total of 60 days'. In the relevant year of assessment, the Appellant had been in Hong Kong in excess of 60 days.

24. In CIR v So Chak Kwong, Jack 2 HKTC 174, it was held that the words 'not exceeding a total of 60 days' in section 8(1B) qualify the word 'visits' and not the words 'services rendered'. Thus, section 8(1B) is not applicable in this case because the Appellant's 'visits' exceeded 60 days, assuming that his trips to and from Hong Kong were 'visits'.

Whether *all* the services rendered outside Hong Kong

25. The Appellant asserted that he rendered all the services in connection with his employment by Listco outside Hong Kong. We reject his assertion and find against him on this factual issue.

(a) The Appellant admitted under cross-examination that he received the minutes at pages 22 to 53 of the Respondent's bundle of documents in Hong Kong, read them in Hong Kong and usually initialled them in Hong Kong. He would put down the initials of the person who should be given a copy of the minutes.

In some cases where approval was sought from him, he gave his approval in Hong Kong.

(b) The Appellant further admitted that some of his 'functions' were carried out in Hong Kong.

(c) In his letter dated 21 August 2001, the Appellant responded to the assessor's statement that the 'reporting of [the Appellant's] duties to the Board of directors by means of meeting notes and verbal meetings in Hong Kong during the year of assessment constitutes a kind of service rendered to [the Appellant's] company', by stating that the 'reporting duties you mentioned in Part (b) of your letter should be seen as an administrative part of my job that was performed in China'. The Appellant did not dispute the fact that he reported to the board orally in meetings held in Hong Kong. Reporting to the board was clearly part of the services rendered by him. It was rendered in Hong Kong. Section 8(1A)(b)(ii) does not treat 'administrative part' of a person's job differently.

Section 61

26. Although the Commissioner did not invoke section 61, Mr Fung Ka-leung has given advance written notice to the Appellant of the Respondent's intention to invoke the provision. We offered the Appellant an opportunity to instruct solicitors or professional accountants. He declined our offer. We see no reason (and none has been put forward by the Appellant) why we should ignore section 61.

27. Section 61 provides that:

' Where an assessor is of opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the person concerned shall be assessable accordingly.'

28. We remind ourselves of the observations made by Lord Diplock, delivering the advice of the Privy Council in Seramco Trustees v Income Tax Commissioner [1977] AC 287 at pages 297 to 298:

' It is only when the method used for dividend stripping involves a transaction which can properly be described as "artificial" or "fictitious" that it comes within the ambit of section 10(1). Whether it can properly be so described

depends upon the terms of the particular transaction that is impugned and the circumstances in which it was made and carried out.

"Artificial" is an adjective which is in general use in the English language. It is not a term of legal art; it is capable of bearing a variety of meanings according to the context in which it is used. In common with all three members of the Court of Appeal their Lordships reject the trustees' first contention that its use by the draftsman of the subsection is pleonastic, that is, a mere synonym for "fictitious". A fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out. "Artificial" as descriptive of a transaction is, in their Lordships' view a word of wider import. Where in a provision of a statute an ordinary English word is used, it is neither necessary nor wise for a court of construction to attempt to lay down in substitution for it, some paraphrase which would be of general application to all cases arising under the provision to be construed. Judicial exegesis should be confined to what is necessary for the decision of the particular case. Their Lordships will accordingly limit themselves to an examination of the shares agreement and the circumstances in which it was made and carried out, in order to see whether that particular transaction is properly described as "artificial" within the ordinary meaning of that word.'

29. Lord Diplock considered whether the impugned transaction was 'unrealistic from a business point of view' (at page 294).

30. In Commissioner of Inland Revenue v D H Howe [1977] HKLR 436 at 441, Cons J (as he then was) considered whether the impugned transaction was 'commercially unrealistic'.

31. In our decision, the employment of the Appellant by Listco was artificial. It was commercially unrealistic. Even if the Appellant had, contrary to our decision, succeeded on the source of employment and on the issue of whether all the services were rendered outside Hong Kong, we would have found against the Appellant under section 61.

(a) The Appellant was the chairman and executive director of Listco.

(b) The head office and principal place of business of Listco was in Hong Kong.

(b) Listco was listed in Hong Kong.

(d) The Appellant rendered part of his services in Hong Kong and part of his services outside Hong Kong.

(e) In the circumstances, it is clearly artificial for the Appellant to be employed and remunerated only for those part of his services rendered outside Hong Kong as 'China Consultant'.

(f) The only reason for the Appellant not to be employed and not to be remunerated for those part of his services rendered in Hong Kong as chairman and executive director was to reduce the Appellant's tax liability in Hong Kong.

Disposition

32. The Appellant has failed on all points. Clearly he has not discharged the onus under section 68(4) of proving that the assessment appealed against is excessive or incorrect. We dismiss the appeal and confirm the assessment as confirmed by the Commissioner.