HCIA 3/2005

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE

INLAND REVENUE APPEAL NO. 3 OF 2005

BETWEEN

LEE HUNG KWONG Appellant

and

THE COMMISSIONER OF INLAND REVENUE Respondent

Before: Deputy High Court Judge To in Court
Date of Hearing: 27 July 2005
Date of Decision: 29 September 2005

D E C I S I O N

Introduction

1. This is an appeal by the Appellant by way of case stated pursuant to section 69 of the Inland Revenue Ordinance (Cap 112) against the decision D60/04 of the Board of Review (the "Board") dated 11 March 2005, dismissing his appeal against the determination of the Deputy

Commissioner of Inland Revenue (the "Respondent") dated 20 April 2004. By that determination, the Respondent increased the Appellant's additional salaries tax assessment for the year of assessment 1994/95, reduced his additional salaries tax assessments for the years of assessment 1995/96 and 1996/97 and confirmed his additional salaries tax assessment for the year of assessment 1997/98. The Appellant required the Board to state a case for the opinion of the Court of First Instance on nine questions. At the hearing of the appeal, Mr Ho, counsel for the Appellant, confirmed that he will proceed with five of the questions only.

The facts found by the Board

2. The Board found the following facts. The Tanrich group of companies ("Tanrich Group") consisted of Tanrich Futures Limited ("Tanrich Futures"), Tanrich Investment Consultant Limited ("Tanrich Investment") and Tanrich (Hong Kong) Holdings Limited ("Tanrich Holdings"). The three companies shared the same address. A Mr Yip was a common director of all the three companies. According to its annual return, the Appellant was a director of Tanrich Investment up to 31 December 1993.

3. At the material times, the Appellant was employed by the Tanrich Group. According to an employer's return of Tanrich Investment, the Appellant was also employed as a sales director of Tanrich Investment for the period between 1 April 1994 and 20 December 1994.

4. According to an undated letter from Tanrich Futures, the Appellant was thereafter employed by Tanrich Futures. There were letters from Tanrich Futures advising the Appellant of his salary revisions. These letters and the Appellant's income tax returns suggest he continued his employment with Tanrich Futures at least until 31 March 2000. The signatory of one of those letters described himself as "The Chief Executive of Tanrich Group".

5. By a letter dated 1 April 2000, Tanrich Holdings informed the Appellant of his salary revision with effect from that date. By another letter dated 6 December 2000, Tanrich Futures advised the Appellant of his salary revision.

6. The employer's returns from the Tanrich Group tallied with the Appellant's income tax returns in respect of the reported income and periods of employment with the different companies of the group.

7. This appeal is concerned with the Appellant's income allegedly from one of a company of the Chung Nam group of companies ("Chung Nam Group"). These companies include: **中南人防實業開發集團** ("Chung Nam Industrial"), **中南國商品期貨交易咨詢服務中** (Chung Nam Futures") and **中南期貨經紀有限公司** ("Chung Nam Brokerage"). The income is described as the Sums in Question in the questions posed by the Board.

8. On 18 February 1993, Chung Nam Industrial entered into a written agreement with Tanrich Investment ("Co-operation Agreement"). The following provisions of the Co-operation Agreement are pertinent:

> Clause 2 referred to Chung Nam Futures as a direct enterprise of Chung Nam Industrial and the wish of Chung Nam Industrial to engage Tanrich Investment as its business consultant;
>
> Clause 3 provided that Tanrich Investment was required to despatch four staff members versed in futures trading to act as principal consultants and business consultants of Chung Nam Futures. They were to assist in the expansion of its futures business and the training of its staff;
>
> Clause 4 provided that 25% of the monthly commission received would be paid to Tanrich Investment as its remuneration;
>
> Clause 5 provided that the engagement was for an initial period of five years from 18 February 1993.

It should be noted that during the major part of this period, the Appellant has ceased to be employed by Tanrich Investment.

9. In June 2001, the Inland Revenue Department commenced investigation into the affairs of the Appellant. On 10 July 2001, the Appellant attended an interview with the Inland Revenue Department in the presence of Mr Daniel Yip, an accountant of Tanrich Holdings. According to the English notes of the interview ("English Note"), the Appellant made the following points:

(a) The Appellant was employed by the Tanrich Group during the period under review.

(b) Since 1994/95, the Appellant was paid a salary and commission. The commission was calculated based on the sales generated by him and his team members.

(c) The Appellant had acted as a consultant in futures trading in Guangzhou since 1994/95 till 1996/97. He considered himself as an employee of Chung Nam Industrial. He produced a staff badge issued by the People' s Liberation Army, which was the entity having control over Chung Nam Industrial.

(d) The Appellant was not aware of the trading name of Chung Nam Industrial in China. He said that the name of Chung Nam Industrial was displayed in the building in which he worked.

(e) The Appellant was responsible for setting up the sales department in China. He prepared training materials for the staff and oversaw the decoration progress in China. When the sales department was in operation, he had to oversee the maintenance of clients' accounts and the reconciliation of clients' investment accounts.

(f) The Appellant prepared all necessary materials, such as training materials and work procedures in Hong Kong during the initial stage of setting up of the sales department in China. Six months later, two other employees, namely Mr Sammy Cheung Wing Cheong and Mr Chui Wing Kit, were stationed in China to oversee the operation in China. At that time he was the manager of the Kowloon Branch of Tanrich Futures.

(g) The Appellant was remunerated in the range of 15% to 20% of the commission income received by Chung Nam Industrial. Mr Chui Wing Kit and Mr Cheung Wing Cheong were not entitled to any share of commission and were remunerated by the Tanrich Group. Occasionally, he paid them bonus, which was about 10% of the commission he received. His commission was paid to him by depositing money into the bank account of King International Limited, a company beneficially owned by him. His commission was calculated once every two months. He received about four million dollars between the years from 1994/95 to 1996/97 from Chung Nam Industrial.

(h) The Appellant only came to know about the amount of his commission payments when he occasionally updated his bank passbook. He believed that the money was paid to him through black market money exchange. A local manager in China, surnamed Chui, was responsible for remitting the commission payments to him. He would be informed once the money, which had been deposited into his bank account.

(i) The Appellant's mother-in-law had good relationship with Chung Nam Industrial because of which he managed to gain trust and earn income from Chung Nam Industrial.

10. By a letter dated 5 September 2001, the Inland Revenue Department sent a copy of the English Note to the Appellant and invited him to comment on any error or inadequacy. The Appellant did not respond. By a letter dated 17 December 2001, the Inland Revenue Department

pressed the Appellant for a response to their earlier letter of 5 September 2001. Both letters were written in English and Chinese. No response was received from the Appellant.

11. By a separate letter dated 17 December 2001, the Inland Revenue Department sought additional information and documents from the Appellant. On 30 August 2002, Messrs Andes Glacier & Co replied to this letter on behalf of the Appellant.

12. By a letter dated 17 September 2002, the Inland Revenue Department reminded the Appellant that various heads of information referred to in the English Note had not been supplied and asked for information in relation to the income which he received from Chung Nam Industrial.

13. By a letter dated 15 December 2002, Messrs Andes Glacier & Co replied with a copy of an agreement dated 20 May 1993 ("Engagement Agreement") purportedly made between Chung Nam Brokerage and the Appellant. According to the Engagement Agreement, Chung Nam Brokerage was a company dealing in futures and engaged the Appellant as its principal consultant to train staff of Chung Nam Brokerage and his remuneration was computed at 20% of the monthly net profit of Chung Nam Brokerage. The Engagement Agreement was signed by the Appellant but not by Chung Nam Brokerage, though it was impressed with a chop bearing the name of Chung Nam Brokerage and another chop bearing the name of Mr Siu Kong Chung.

14. By a further letter dated 22 May 2003, Messrs Andes Glacier & Co submitted a summary of the Appellant' s income from China, which were the Sums in Question. The Appellant claimed that the payments were remitted to Hong Kong or paid to him by cash in China. The issue before the Board was whether the Sums in Question referred to in this letter should be assessed to Salaries Tax.

15. In reply to the enquiries from the Inland Revenue Department, Tanrich Futures informed the Inland Revenue Department the followings:

(a) Tanrich Futures and the Appellant entered into an employment contract in Hong Kong on 21 December 1994.

(b) The Appellant was not required to work outside Hong Kong under his contract of employment with Tanrich Futures.

(c) The Appellant was seconded to work in Chung Nam Futures in China from 1993. Tanrich Futures was not a related company to Chung Nam Futures. The Appellant needed not perform any service for Tanrich Futures during his secondment in China.

(d) The remuneration paid by Chung Nam Futures to the Appellant was negotiated between the two parties concerned. Tanrich Futures had no information on how the remuneration was calculated.

It should be noted that under the Co-operation Agreement between Tanrich Investment and Chung Nam Industrial, Tanrich Investment was to provide consultancy service to Chung Nam Futures. The secondment to Chung Nam Futures referred to in Tanrich Futures' reply is therefore consistent with the Co-operation Agreement but inconsistent with the Appellant's assertion of his employment with Chung Nam Brokerage under the Engagement Agreement.

The proceedings before the Board

16. The Board heard evidence from the Appellant and his three witnesses. The three witnesses were Mr Chui Wing Kit, a former employee of Tanrich Futures seconded to Chung Nam Futures, Mr Toru, a director of the Tanrich Group and Mr Tsui Hoi Chui, a former employee of Chung Nam Brokerage who witnessed the execution of the Engagement Agreement. The Appellant's case before the Board was that he was employed under the separate Engagement Agreement with Chung Nam Brokerage and the Sums in Question were his remuneration under that agreement. The Board did not find the Appellant an honest witness and rejected his evidence. The Board came to the conclusion that the Appellant's case is wholly inconsistent with what he said during the interview on 10 July 2001 as recorded in the English Note. The Board found the Appellant did not make timely challenge of the English Note and rejected his explanation that his lack of response to the English Note was because of his difficulties with the English language. The Board considered the letter dated 30 August 2002 from Messrs Andes Glacier & Co confirmed the accuracy of the English Note in a material respect. In particular, the Board rejected the Appellant's evidence about his Engagement Agreement with Chung Nam Brokerage because he made no reference to that company or that agreement during the interview on 10 July 2001. The Board came to the conclusion that the Appellant did say what was recorded in the English Note and that what he said there was true.

17. The Board made the finding of fact in paragraphs 2 to 16 above. It rejected the Appellant's case that he had a separate Engagement Agreement with Chung Nam Brokerage and that the Sums in Question were his remuneration under that agreement. The Board concluded that the Appellant was sent by each of Tanrich Investment, Tanrich Futures and Tanrich Holdings to discharge the obligations of Tanrich Investment under the Co-operation Agreement and the Sums in Question were income arising in or derived from Hong Kong from the Appellant's employment with the Tanrich Group. There being no credible evidence that tax had been paid in China in respect of those income, the Board rejected the Appellant's suggestion that the income should be excluded on the basis of section 8(1A)(c) of the Inland Revenue Ordinance. Accordingly, the Board upheld the determination of the Deputy Commissioner of Inland Revenue dated 20 April 2004 and dismissed the Appellant's appeal.

The ambit of an appeal by way of a case stated

18. Although the Appellant has formulated nine questions for the opinion of the Court, the central issue is simply whether the Board was correct in applying the law to the facts it found and in coming to the conclusion that the Sums in Question received in China by the Appellant were income arising from or derived from his employment with the Tanrich Group and therefore should be assessed to salaries tax.

19. Since this is an appeal by way of case stated pursuant to section 69 of the Inland Revenue Ordinance, the powers of the Court of First Instance are very limited on an appeal and are only confined to expressing an opinion on the questions of law in the case stated. The Court may only interfere with the Board's decisions:

(1) if the Board has misdirected itself in law: *Edwards And Bairstow And Another* [1956] AC 14 at 36; or

(2) if it has drawn inferences or come to conclusions which cannot stand because the primary facts found by it do not admit of such inferences or conclusions and the Court may not substitute its own inferences and conclusions for those of the Board's: *Commissioner of Inland Revenue And Inland Revenue Board of Review and Another* [1989] 2 HKLR 40; and

(3) where there was no evidence on which the primary facts themselves could be based or where the Board should have made findings of other relevant primary facts: *Commissioner of Inland Revenue And Inland Revenue Board of Review and Another* [1989] 2 HKLR 40.

20. So far as the law is concerned, the issue is what is the proper interpretation of the charging section creating the tax liability and particularly what is the proper test for determining the source of income for the purpose of the charging section. As for appeal against the finding of fact of the Board, the powers of this Court are very limited.

The charging provision: section 8 of the Inland Revenue Ordinance

21. The salaries tax assessment was raised under section 8 of the Inland Revenue Ordinance which provides:

"(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; and

(b) any pension.

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

(a) includes, without in any way limiting the meaning of the expression and subject to paragraph (b), all income derived from services rendered in Hong Kong including leave pay attributable to such services;

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

(i) is not employed by the Government or as master or member of the crew of a ship or as commander or member of the crew of an aircraft; and

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

(c) excludes income derived by a person from services rendered by him in any territory outside Hong Kong where-

(i) by the laws of the territory where the services are rendered, the income is chargeable to tax of substantially the same nature as salaries tax under this Ordinance; and

(ii) the Commissioner is satisfied that that person has, by deduction or otherwise, paid tax of that nature in that territory in respect of the income.

(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. The leading and only local authority on the interpretation of section 8 is *Commissioner of Inland Revenue v George Andrew Goepfert* [1987] HKTC Vol 2 210. Macdougall J held at 236:

"As a matter of statutory interpretation I am unable to escape the conclusion that, although sec 8(1) must be construed in the light of and in conjunction with section

> 8(1A), section 8(1A)(a) creates a liability to tax additional to that which arises under section 8(1). It is an extension to the basic charge under section 8(1). If it were otherwise section 8(1A)(a) would be virtually otiose and section 8(1A)(b) completely unnecessary."

23. I have quoted the section in full. I fully concur with the view of Macdougall J. It is plainly obvious that the charge or the liability to salaries tax is created by section 8(1). The crucial words of the charge are income arising in or derived from Hong Kong from one of the two sources, namely (a) any office or employment of profit and (b) any pension. Section 8(1A)(a) expressly brings into the charge income derived from services rendered in Hong Kong and section 8(1A)(b) expressly excludes income from certain categories of persons who render outside Hong Kong all the services in connection with their employment. Both subsections are silent as to the source of the income thus included or excluded. If the income included under section 8(1A)(a) is an income from a Hong Kong source, the subsection clearly serves no useful purpose. The purpose of the subsection must be to bring into the charge income from a source outside Hong Kong if the services are rendered in Hong Kong. Likewise, the purpose of section 8(1A)(b) must be to exclude from the charge an income from a Hong Kong source if the person renders outside Hong Kong all services in connection with his employment. Thus, the question which falls to be decided in any particular case is whether the income which is sought to be charged is income from a Hong Kong source and the place where the services are rendered is irrelevant. If the income is from a Hong Kong source, it is subject to the charge whether the services are rendered in or outside Hong Kong, unless it falls within the exception under section 8(1A)(b).

24. In *Goepfert*, after satisfying himself that the question posed under the United Kingdom taxing statue was essentially the same question posed under section 8(1) of the Inland Revenue Ordinance, Macdougall J adopted the principles developed in the English cases, *Foulsham v Pickles [1925]* AC 458, *Bennett v Marshall* [1938] 1 KB 591 and *Bray and Colenbrander*; *Harvey and Breyfogle* [1953] AC 503. These cases were decided in 1925, 1938 and 1953 respectively, the first and last having been decided by the House of Lords and the second one by the Court of Appeal. In *Bray and Colenbrander*; *Harvey and Breyfogle*, after reviewing the earlier authorities, Lord Normand concluded at 511:

> "The House of Lords … in *Foulsham v Pickles* have definitely decided that in the case of an employment the locality of the source of income is not the place where the activities of the employee are exercised but the place either where the contract for payment is deemed to have a locality or where the payments for the employment are made, which may mean the same thing."

Thus, where the source of income is from an employment, the locality of the source of income is the place where the contract for payment is deemed to have a locality. By "contract for payment", Lord Normand must mean the contract of employment based on which the employee earned his payment and not necessarily the place where the payments are made. The place of payment is of

course an important indicator of the locality of the contract and is prima facie the locality of the contract. But it is not be conclusive: see for example *Bennett v Marshall*. If an employee enters into a contract of employment in Hong Kong with an employer resident in Hong Kong but had his salary paid into his Swiss bank account, it can hardly be doubted that the locality of his contract is in Hong Kong. His income is from a Hong Kong source. In most cases, the place of payment is the locality of the contract. That must be why Lord Normand said that the two ***may*** mean the same thing, but not that the two mean the same thing.

25. As for the test for ascertaining the source of income, Sir Wilfrid Greene MR said in *Bennett v Marshall* at 611:

> "The language, in [*Foulsham and Pickles*], it seems to me, quite clearly establishes the proposition that the place where the work is carried out is not a matter to which attention should be directed. If I am right in my view as to the effect of *Foulsham v Pickles*, it has the result in this case that the test for ascertaining the source of income is to look for the place where the income really comes to the employee."

26. The judgment of Sir Wilfrid Greene MR in *Bennett v Marshall* was approved by the House of Lords. Thus, the test as to the source of income is to look for the place where the income really comes to the employee. As Sir Wilfrid Greene MR said, regard must first be had to the contract of employment. This must include consideration as to the place where the employee is to be paid, where the contract of employment was negotiated and entered into and whether the employer is resident in the jurisdiction. But none of these factors are determinative. If the employer is resident in Hong Kong and entered into a contract of employment with an employee in Hong Kong, the employer must be carrying on business in Hong Kong from which the employer' s profits in substance arise. The locality of the contract must therefore also be in Hong Kong: see for example, *Foulsham and Pickles*. On the other hand, if the employer is not resident in Hong Kong, but came to Hong Kong to recruit employees to work exclusively in China. The locality of the contract is not in Hong Kong. Consideration of these factors shows the very process adopted in ascertaining the locality of the contract. This is perhaps what have been referred to as the totality test.

27. Having set out the test for determination of the source of income, I now turn to the questions posed by the Board.

Question (a)

28. The first question posed by the Board is:

> "Whether, on the facts found, the Board erred in law in holding that the remuneration received from services in Mainland China referred to in paragraph 27 above (i.e. income from 1994/95 to 1997/98) (the "Sums in Question") were income arising in

> or derived from Hong Kong. Whether, on the facts found, the Board erred in law in holding that the Sums in Question were income derived from the Appellant's employments with Tanrich Investment, Tanrich Futures and Tanrich Holdings."

This Question is made up of two parts. The first part is a general question while the second part is specifically directed to each of the companies in the Tanrich Group.

29. I have set out the finding of fact of the Board in paragraphs 2 to 15 and its conclusion in paragraphs 16 and 17. The Board found the Appellant incredible and rejected his evidence. In particular, the Board rejected his evidence that he had a separate Engagement Agreement with Chung Nam Brokerage and that the Sums in Question he received were his remuneration under that agreement. The evidence which the Board accepted are:

(1) Tanrich Investment and Chung Nam Industrial entered into the Co-operation Agreement in February 1993 to provide consultancy and training services for Chung Nam Futures;

(2) it was a term of that agreement that Tanrich Investment shall provide four staff to Chung Nam Futures for that purpose;

(3) the Appellant was a director of Tanrich Investment up to 31 December 1993 and its sales director between 1 April 1994 and 20 December 1994;

(4) thereafter the Appellant was employed by Tanrich Futures with short spells by Tanrich Holdings;

(5) between 1994/95 and 1996/97 the Appellant worked half time in Tanrich Futures and half time in Chung Nam Industrial;

(6) the Appellant prepared training materials for the staff of Chung Nam Futures and supervised its operation;

(7) the Appellant supervised the two full time staff sent by the Tanrich Group to work in Chung Nam Futures;

(8) while the Appellant was in Hong Kong, the two full time staff sought advice from him through IDD;

(9) the Appellant's remuneration from China, i.e. the Sums in Question were deposited into his bank account in Hong Kong.

30. Putting aside, for the time being, the separate identities of the three Tanrich companies and treating them collectively as one legal entity, the Tanrich Group, it was open to the Board to find on the above facts that the Appellant was employed by Tanrich Group to discharge the obligation of the Group to Chung Nam Industrial under the Co-operation Agreement. The question, then, is whether the Appellant's remuneration from China was income from a Hong Kong source.

31. Mr Ho argued that it was the Appellant's case that the Sums in Question were not paid by the Tanrich Group but were paid from funds in China. He further submitted that there was no explicit finding by the Board to the contrary and that this weighed heavily in favour of his argument that the Sums in Question were from a source outside Hong Kong. The quick answer to that submission is to be found in section 9 of the Inland Revenue Ordinance. That section defines income from any office or employment to include any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others. The section treats payments such as bonus and commission etc by persons other than the employer as part of the taxpayer's income. Thus, even if the Sums in Question were paid by the Chung Nam Group or from funds in China, it did not cease to be the Appellant's income for the purposes of the Inland Revenue Ordinance. The important question is whether that income is from a Hong Kong source.

32. The answer to that question is to be found by applying the test of Sir Wilfrid Greene MR in *Bennett v Marshall*, i.e. the place where the income really comes to the Appellant. The Board has rejected the Appellant's evidence that the Sums in Question were derived from his Engagement Agreement with Chung Nam Brokerage. It must be derived from his contract of employment with the Tanrich Group. It was in the performance of his obligation under that contract of employment that the Appellant went to China and earned the Sums in Question. That contract of employment was entered into in Hong Kong. That contract is enforceable in Hong Kong. His employers were the Tanrich Group which were resident in Hong Kong. He worked under the direction of the Tanrich Group. All these consideration must outweigh the consideration that the Appellant was paid in China, even if that was the case. The Sums in Question, even if they were paid in China from funds in China, were nevertheless from a Hong Kong source. They were income arising in or derived from Hong Kong for the purpose of the Inland Revenue Ordinance. Thus, the answer to the first part of Question (a) is in the negative.

33. I now turn to the second part of the Question. The Board was conscious of the legal issue raised by the separate identities of the three companies of the Tanrich Group. The Board held in paragraphs 45 and 46:

> "45. The Board was however concerned with one aspect of the Revenue's case. The Revenue had presented its case on the basis that the Appellant was employed by the Tanrich Group. The Tanrich Group is not a legal entity. On the evidence before the Board, the Appellant's employment was with Tanrich Investment, Tanrich Futures and Tanrich Holdings, his employment with

> Tanrich Investment ceased on 20 December 1994 and he left the Board of Tanrich Investment by 14 May 1995. The Co-operation Agreement was made between Tanrich Investment and Chung Nam Industrial. Tanrich Futures and Tanrich Holdings were not parties to that agreement. This casts doubt on whether the sums in question were derived from Hong Kong from the Appellant's employment with Tanrich Futures and Tanrich Holdings.
>
> 46. The Board's concerns referred to in paragraph 45 above were dispelled by the following factors. First, the Appellant himself told the Revenue at the 10 July 2001 interview that the sums in question stemmed from the Sales Department which he set up in China. The Board had no doubt that his initial entry into entry into China was the result of his employment with Tanrich Investment. Secondly the Appellant further said at the 10 July 2001 interview that he was paid by Ching Nam Industrial and he made no distinction between the years from 1994/1995 to 1996/97. Thirdly, reference to the notion of the Tanrich Group can also be found in the Appellant's evidence. Mr Toru described himself as a director of the Tanrich Group. Revision of the Appellant's employment terms on 16 May 1996 was made on behalf o the Tanrich Group. Tanrich Futures expressed gratitude on 6 December 2000 for the Appellant's contribution to the Group. Fourthly, Tanrich Futures said in its letter dated 14 May 2002 that the Appellant was seconded to Chung Nam Futures. Fifthly, Tsui Wing Kit was also an employee of Tanrich Futures at the material times. It is the Appellant's case that he was sent to discharge the obligations of Tanrich Investment under the Co-operation Agreement. Given the admissions of the Appellant at the 10 July 2001 interview, we find no material distinction between the Appellant's position and that of Tsui Wing Kit on this issue. For these reasons the Board concluded that the Appellant was sent by each of Tanrich Investment, Tanrich Futures and Tanrich Holdings to discharge the obligations of Tanrich Investment under the Co-operation Agreement. The sums in question were income arising in or derived from Hong Kong from the Appellant's aforesaid employments."

In my view, the Board has considered this issue with admirable clarity and cannot be faulted in the conclusion it reached.

34. Furthermore, putting everything in its proper time context, the Appellant was an employee, a director and a sales director of Tanrich Investment when he worked for Chung Nam Futures in China. The logical inference must be that he was sent by Tanrich Investment to discharge the obligations of Tanrich Investment under the Co-operation Agreement. Then, on his own evidence, he worked half time in China and half time in Tanrich Futures since 1994/95 and he gave advice to the staff sent to provide consultancy and training service for Chung Nam Futures via IDD when he was in Hong Kong. The logical inference must be that the Appellant continued to work

under that initial arrangement to discharge the obligations of Tanrich Investment under the Co-operation Agreement with the consent and agreement of Tanrich Investment and Tanrich Futures, even though he became employed by Tanrich Futures with effect from 21 December 1994. The further logical inference must be that the Appellant continued to work in Chung Nam Futures in the discharge of the obligations of Tanrich Investment as a result of inter-company arrangement between the two associated companies in the Tanrich Group. The Appellant would not and could not have earned the Sums in Question if he were not employed by Tanrich Investment or Tanrich Futures. The Appellant's contract of employment with Tanrich Investment prior to 20 December 1994 and thereafter with Tanrich Futures were the employment contracts from which the Sums in Question were derived. It was in the performance of his obligation under these two contracts of employment that he started and continued to work in Chung Nam Futures in China and earned the Sums in Question. Thus, for similar reasons as those in paragraph 32, the Sums in Question, even if they were paid in China from funds in China, were from a Hong Kong source. The only error the Board made was to mention Tanrich Holdings because the Sums in Question were not earned while the Appellant was in the employment of Tanrich Holdings. But this error has no bearing on the Board's conclusion.

35. For the above reasons and those of the Board's, the answer to the second part of Question (a) is also in the negative.

Question (b)

36. The second question posed by the Board is:

> "Whether the Board took irrelevant consideration into account and thus erred in law in concluding that the Sums in Question was derived from his employment with Tanrich Investment, Tanrich Futures and Tanrich Holdings, the said irrelevant consideration being set out in paragraph 46 above."

37. Mr Ho made no submission as to what were the irrelevant considerations which the Board had taken into account and why they were irrelevant. I have quoted paragraph 46 of the Case Stated by the Board in paragraph 33 above. I concur with the reasoning of the Board. Nothing of what were considered by the Board were irrelevant. The answer to this question must be in the negative.

Question (c)

38. The third question posed by the Board is:

> "Whether, on the facts found, the true and only reasonable conclusion must be that the Sums in Question were income derived from an employment located in Mainland

> China such that the sums attributable to services rendered outside Hong Kong is not chargeable to Hong Kong tax."

39. This is in fact a different way of asking Question (a). The Board having concluded that the Sums in Question were income derived from an employment in Hong Kong must exclude the possibility that they were derived from an employment located in China. On the facts found by the Board, the answer to this question must also be in the negative. Whether the Board has properly made those finding of fact on the evidence before it is to be considered in the other questions posed by the Board.

Question (d)

40. The fourth question posed by the Board is:

> "Whether the Board's finding that the Appellant did not have a separate Engagement Agreement with Chung Nam Brokerage and that the Remuneration from China were remuneration under that agreement was inconsistent with or contradictory to the evidence and thus erred in law in holding that the Sums in Question were income arising in or derived from Hong Kong."

41. This is in fact an appeal against the finding of fact of the Board dressed up as a question of law. I have identified the limitation this Court is subjected to on an appeal under section 69 of the Inland Revenue Ordinance. The burden is on the Appellant to show that the Board has misdirected itself in law, if it has drawn inferences or come to conclusions which cannot stand because the primary facts found by it do not admit of such inferences or conclusions and there was no evidence on which the primary facts themselves could be based or where the Board should have made findings of other relevant primary facts.

42. The Board decided for the reasons set out in paragraph 40 to 43 of the Case Stated to reject the Appellant's case that he had a separate Engagement Agreement with Chung Nam Brokerage. In essence, the Board rejected the Appellant's evidence for the following reasons:

(a) the Appellant's case is wholly contrary to the English Note and he made no timely challenge of the accuracy of the English Note;

(b) Messrs Andes Glacier & Co confirmed the accuracy of the English Note in a material respect;

(c) the Appellant's denial of any knowledge of Chung Nam Futures cannot be reconciled with Tanrich Futures' assertion in its letter dated 14 May 2002 that the Appellant was seconded to work in Chung Nam Futures since 1993;

(d) his new but inconsistent explanations on the payments made by King International Limited in favour of Mr Chui Wing Kit and Mr Cheung Wing Cheong;

(e) the Appellant's failure to make any reference to Chung Nam Brokerage or the Engagement Agreement and to identify the trading name of that company during his interview on 10 July 2001;

(f) the Appellant's indication during his interview on 10 July 2001 that he was able to earn income from Chung Nam Industrial because of his mother-in-law's relationship with Chung Nam Industrial is inconsistent with his new case that he was introduced to Chung Nam Industrial by Mr Yip;

(g) the Board viewed with suspect the evidence of Mr Tsui Hoi Chui who witnessed the execution of the Engagement Agreement;

(h) the Board was not impressed with Mr Chui Wing Kit's evidence that he incurred substantial amounts on behalf of the Appellant on gifts and trips;

(i) though the Board found Mr Toru an honest witness, the Board gave little weight to his evidence as he was not a director of Tanrich Investment, had little involvement with the Chung Nam Group, had no personal knowledge of the arrangement between the Appellant and Chung Nam Group and cannot identify the staff sent to the Chung Nam Futures to train the staff there.

43. Mr Ho made a number of attacks on the above reasoning of the Board. Firstly, he sought to play down the significance with which the Board attached to the Appellant's failure to mention Chung Nam Brokerage in the 10 July 2001 interview (Reason (e)). He argued that very often one would tell others in a loose way that he was employed by the group rather than the particular member of the group. It is true that ordinary people in ordinary day to day or casual conversation would indulge in loose and imprecise language. But the interview was not an occasion for casual talks. The Appellant attended with an accountant from Tanrich Holdings. He attended the interview as a subject under investigation in respect of his tax liability. He must know the importance to be accurate and precise. This apart, he could not even mention the name of Chung Nam Brokerage when his attention had been specifically directed to the trading name of the entity he was working for and which earned him the substantial Sums in Question. Not only that, this reason should not be considered in isolation but in the totality of all the circumstances. Those circumstances include the Appellant's lack of timely challenge to the accuracy of the English Note, Messrs Andes Glacier & Co confirmation in their letter dated 30 August 2002 and Tanrich Futures' assertion in its letter dated 14 May 2002 that the Appellant was seconded to work in Chung Nam Futures since 1993. It was a question of weight for the Board. It was certainly open to the Board to take into account the Appellant's failure to mention Chung Nam Brokerage at the

10 July 2001 interview and in the light of that failure to assess the inherent probability of his case and his credibility.

44. Mr Ho complained that the Board criticised the inconsistency between the Appellant's evidence as to whether he was introduced to Mr Siu of the Chung Nam Group by Mr Yip or by his mother-in-law. It cannot be disputed that the Appellant was inconsistent. Mr Ho was unable to argue why the inconsistency should be ignored and how the failure to ignore that inconsistency could have adversely affected the reasoning of the Board. It was a question of weight for the Board.

45. Mr Ho criticised the Board for disbelieving Mr Tsui Hoi Chui's evidence. Mr Tsui Hoi Chui was the financial manager of Chung Nam Brokerage. His evidence was that he witnessed the execution of the Engagement Agreement. The Board doubted his evidence because he failed to state precisely the Appellant's entitlement under the Engagement Agreement, whether it was 20% of the commission of Chung Nam Brokerage or 20% of its net receipt or 20% of its net profit. Mr Tsui was the financial manager. His equivocal evidence in respect of a matter which he was supposed to be conversant must render his evidence suspect. This was again a question of weight for the Board.

46. With respect to Mr Ho, he failed to set out the facts straight. As can be seen from the list of nine reasons upon which the Board rejected the Appellant's case, the three reasons which Mr Ho criticised were very minor ones. On my analysis Mr Ho's criticisms were quite unjustified. In my view, on those evidence presented to the Board and for the reasons as given by the Board, it was open to the Board to reject the Appellant's evidence and his case.

47. Next, Mr Ho launched a collateral attack on the Board's finding by arguing that the Appellant was not sent to discharge the obligation of Tanrich Investment under the Co-operation Agreement. He said there was no evidence to support such a conclusion. He referred to the Board's initial concern about the separate identities of the three Tanrich companies (paragraph 45 of the Case Stated). He seized on the point that while working in China, Mr Chui Wing Kit and Mr Cheung Wing Cheong were paid by the Tanrich Group and not by the Chung Nam Group while the Appellant was paid by the Chung Nam Group but not by the Tanrich Group in respect of his services rendered in China. He also seized on the point that Mr Chui Wing Kit and Mr Cheung Wing Cheong were not issued a staff badge by Chung Nam Industrial whereas the Appellant was. He submitted that this difference is so vital that the Board must be wrong to infer that the Appellant was in the same position as Mr Chui Wing Kit and Mr Cheung Wing Cheong.

48. This was again a question of weight for the Board which had to be determined on the totality of the evidence and not just pieces of evidence in isolation. It was not disputed that the Appellant was an employee and director of Tanrich Investment up to 20 December 1994 and since 1994/95 he had been working half time for Chung Nam Industrial and half time for Tanrich Futures. The inference that the Appellant was sent to discharge the obligation of Tanrich Investment which

the Board can draw from this fact must be far stronger than the inference which could be drawn from the relatively insignificant differences identified by Mr Ho.

49. Mr Ho also raised some minor points. I deal with them very briefly. Mr Ho argued that as Mr Chui Wing Kit and Mr Cheung Wing Cheong were employees of Tanrich Futures, there was nothing unusual for the Appellant to give them advice through IDD in respect of the operation of Chung Nam Futures in China. This was also a question of weight. In my view, this argument cuts both way but much deeper against the Appellant than against the Respondent.

50. Mr Ho submitted that the reason for the Appellant making bonus payments to Mr Chui Wing Kit and Mr Cheung Wing Cheong were not apparent from the Board's decision. It was not and I am not going to surmise. This was also a question of weight. If this fact was not of significance, the Board would have given it no weight in its deliberation. Mr Ho has failed to argue how this fact could have turned out in favour of the Appellant.

51. In the light of his criticisms above, Mr Ho submitted that the irresistible inference is that there must exist an agreement between the Appellant and the Chung Nam Group for the payment of the Sums in Question and that the payment was in consideration for the Appellant's services in China. He further submitted that as the Sums in Question were not paid by the Tanrich Group but by the Chung Nam Group, the Board erred in rejecting the Appellant's case.

52. Mr Ho argued that as the Board found Mr Toru an honest witness, the Board should not have discounted his evidence. He emphasised that Mr Toru confirmed that the Tanrich Group did not pay for the Appellant's services in China. I agree with the Board's view and reasons that Mr Toru's evidence is of no assistance to the Appellant. Basically, Mr Toru had no personal knowledge about the Co-operation Agreement and about the arrangement between the Appellant and the Tanrich Group in respect of the Appellant's services rendered in China. The fact that the Tanrich Group did not pay the Appellant in respect of his services rendered in China is not in dispute and as explained even if the Sums in Question were paid by the Chung Nam Group, it is irrelevant by virtue of section 9 of the Inland Revenue Ordinance. The Board was right not to give any weight to Mr Toru's evidence.

53. Mr Ho argued that neither the Respondent nor the Board challenged the truth of the written information supplied by Tanrich Futures, namely that the Appellant was not required to work outside Hong Kong, that he was seconded to Chung Nam Futures since 1993 and that the remuneration paid by Chung Nam Futures to the Appellant was negotiated between the two parties concerned. Though the Board made no specific finding in respect of the above matters, it is obvious from its conclusion that the Board disbelieved the information. By finding that the Appellant was sent to work in China and continued to work thereafter in discharge of the obligation of Tanrich Investment under the Co-operation Agreement, the Board must have rejected the assertion of Tanrich Futures that the Appellant was not required to work outside Hong Kong. The fact that the Board accepted what the Appellant said during the 10 July 2001 interview that he

worked half time in China and half time in Hong Kong must mean that the Board rejected the assertion that the Appellant was seconded to Chung Nam Futures on a full time basis. This actually supports the inference that the Appellant was working for the Tanrich Group and at the same time discharging its obligation under the Co-operation Agreement. Whether Tanrich Futures or Tanrich Group paid the Appellant in respect of his services rendered in China is neither here nor there in view of section 9 of the Inland Revenue Ordinance.

54. Mr Ho argued that the Board's finding that Tanrich Holdings was one of the companies which sent the Appellant to serve under the Co-operation Agreement must be wrong as Tanrich Holdings only commenced to employ the Appellant as from 1999/00. This criticism arose from what the Board said in paragraph 46 of the Case Stated that "the Appellant was sent by each of Tanrich Investment, Tanrich Futures and Tanrich Holdings to discharge the obligations of Tanrich Investment under the Co-operation Agreement." The Board was unequivocal in finding that the Appellant's initial entry into China was the result of his employment with Tanrich Investment. In its proper context, what the Board said must be viewed in the context of an inter-companies arrangement between associated companies, i.e. the Appellant was sent to work in China and continued to work in China as a joint arrangement among all the three Tanrich companies. It is true that Tanrich Holdings did not come into the picture so far as the Sums in Question are concerned. But nothing significant turned on that point.

55. Lastly, on this question, Mr Ho submitted the fact that the employers' return did not include the Income in Question supports the Appellant's case and the Board has failed to take that into account. I think this is just begging the question. On the finding of the Board, the Board must have considered the information in the returns erroneous and gave no weight to those returns.

56. In conclusion, the question posed is essentially an attack on the Board's finding of fact. On the evidence, it was open to the Board on its own assessment of credibility of the witnesses and assessment of the weight to be attached to their evidence to come to the conclusion that Appellant did not have a separate Engagement Agreement with Chung Nam Brokerage and the Sums in Question were income arising in or derived from Hong Kong. The Board has not erred in law in making this finding. Accordingly, the answer to this question is in the negative.

Question (g)

57. The seventh question posed by the Board is:

> "Whether the Board made a mistake in finding the fact, as set out in paragraph 45 of its decision, that it was the Appellant's case that he was sent to discharge the obligations of Tanrich Investment under the Co-operation Agreement when this has never been the Appellant's case and thus erred in law in holding that the Sums in Question were arising in or derived from Hong Kong."

Reference to paragraph 45 in this question should in fact be paragraph 46 of the Case Stated. This paragraph has been set out in full in paragraph 33.

58. Indeed, it never was the Appellant's case that he was sent to discharge the obligations of Tanrich Investment under the Co-operation Agreement. It was a mistake for the Board to have said so. It can be seen from the third sentence of paragraph 46 of the Case Stated that it was the Board's finding that the Appellant's initial entry into China was to discharge the obligation of Tanrich Investment under the Co-operation Agreement. Probably, the Board was quoting its finding as to the Appellant's initial entry into China but inadvertently used the words "the Appellant's case" instead of "the Board's finding". I do not wish to surmise. I accept that the Board made the mistake. I now consider whether as a result of that mistake the Board erred in law in holding that the Sums in Question were income arising in or derived from Hong Kong.

59. As can be seen from paragraph 30 and 31 of the Case Stated, the Board had no misapprehension as to what the Appellant's case was. In those two paragraphs, the Board set out fully the contentions of the Appellant. It is clear from the Case Stated that the Board had borne those contentions in mind, but in the end dismissed those contentions when it said in paragraph 44 of the Case Stated that "the Board rejected the Appellant's case that he had a separate Engagement Agreement with Chung Nam Brokerage and that the Sums in Question were remuneration under that Agreement." This is the clearest indication that the Board made no mistake as to what the Appellant's case really was. I have no doubt that in rejecting what in truth was the Appellant's case, the Board did not do so on the erroneous belief that it was the Appellant's case that he was sent to China to discharge the obligations of Tanrich Investment. The mistake which found its way into decision of the Board was just an inadvertent mistake which in no way affected the very well considered decision of the Board. On the evidence, the Board is entitled to reject the Appellant's case based on the Engagement Agreement. This is a finding of fact which I have fully considered in answering Question (d). For those reasons, the Board could not have faulted in finding the Sums in Question as income derived from Hong Kong.

60. However, Mr Ho raised an alternative argument that even if the Board had found that the Appellant was sent to discharge the obligations of Tanrich Investment under the Co-operation Agreement, the source of the income was not in Hong Kong but in China. He submitted that the Board placed undue emphasis on whether the Appellant had a contract of employment with an employer resident in Hong Kong and ignored the other material facts, in particular, that the Sums in Question were paid from money originated in China. He quoted Lord Dunedin's and Lord Buckmaster's dicta in *Foulsham and Pickles* [1925] AC 458 in support of his argument. Lord Dunedin said at 466:

> "This income comes from the contract of employment made in the United Kingdom. When I say made in the United Kingdom I am not referring to the place where the signing of the contract took place. I am referring to the source of the profit which is

> the payment which the employers covenanted to make. This was payable and paid in London."

At 468, Lord Buckmaster said:

> "In the present case I do not think that the source of income was the employment of the respondent in West Africa. The source of his income was the money paid by an English company into an English bank in pursuance of an agreement for services made in this country."

Next he referred to MacKinnon LJ's dicta in *Bennett v Marshall* [1938] 1 KB 591. The taxpayer in that case entered into a contract of employment in USA while his income was paid to him in Canada by remittance from the USA. MacKinnon LJ said at 614:

> "The question then is: What is the source of the income of the respondent's employment? … clearly, that it was in Ohio in the United States … The contract under which the respondent was employed was made in Ohio, and his remuneration arising from that contract was paid to him in Canada by remittance from Ohio."

Hence, Mr Ho submitted that the English cases placed importance on the origin of the payment and that the source of funds is determinative of the place where the income really comes to the employee. He submitted that the present case was in all fours with *Bennett v Marshall* as the Sums in Question were remitted to the Appellant's bank account from China to Hong Kong.

61. With respect to Mr Ho, he was drawn by the superficial similarities between *Bennett v Marshall* and the present case and tended to follow precedents by applying the results decided on the factual circumstances of that case instead of applying its legal principle to the factual circumstances of the instant case. He back-tracked into issues which were considered in connection with the earlier Questions. Most fatally, he mixed up two different questions; i.e. what is the source of the income and what is the source of funds to pay that income. In my view, on the facts of the instant case only the first question is relevant. As I have already pointed out, what is subject to tax is the income from a Hong Kong source and the test as to the source of income is to look for the place where the income really comes to the employee. This is the test set out by Sir Wilfrid Greene MR in *Bennett v Marshall* and approved by the House of Lords. Neither *Bennett v Marshall* nor *Foulsham and Pickles* purported to lay down any principle of law that the source of funds used to pay an employee is the source of his income, though in the factual circumstances of those two cases' it was. An important and distinguishing feature in the present case which is absent in *Bennett v Marshall* and *Foulsham and Pickles* is that the Appellant in this case was sent to work in China under his contract of employment with the Tanrich Group. Thus when applying Sir Wilfrid Greene MR's test in *Bennett v Marshall*, it is incumbent upon the Board to look for the contract of employment, the resident of the employer etc rather than to look for the source of funds for paying the income. The place where the payments for the employment are made is relevant but

not conclusive. On the facts of the present case, that must be of secondary importance to the Appellant's contract of employment in performance of which obligation he was sent to China to earn the income. Had the Board accepted the Appellant's case that he had a separate Engagement Agreement with Chung Nam Brokerage, I would have agreed that the case is on all fours with *Bennett v Marshall* and the source of the income should be regarded as an outside source. For the above reasons, I consider the approach of the Board proper and the conclusion it reached correct. Mr Ho's criticism that the Board placed undue weight on the residence of the employer and the location where the contract was entered into was unjustified. His submission that the English cases placed importance on the origin of the payment was misconceived.

62. Next, Mr Ho referred to a number of Board decisions on secondment which ruled that a taxpayer changed the location of his employment for tax purpose upon assignment or secondment to another locality. This argument had been presented before the Board. The Board did not find it necessary to consider secondment. Neither do I. There is no definition of secondment under the Inland Revenue Ordinance. In Board of Review Decision D55/91, the Board held that secondment is a period of temporary employment at the end of which the employee returns to his general employment. I concur with that view. Depending on the circumstances of the case, a secondment may be based on a contract of service made between the temporary employer and the employee with the consent of the general employer, or it may simply be a case of the general employer directing the employee to go and do some work for the temporary employer without involving the creation of a contract of service between the temporary employer and the employee. A secondment does not necessarily change the location of employment. It depends on the terms of the secondment and in particular and ultimately where the income comes to the employee, i.e. the source of the income, etc. In the eventual analysis, it is this question which has to be determined and it has to be determined by looking for the place where the income really comes to the employee. In answering the above four questions, I have found that the Board applied the proper test and reached the correct conclusions. If there was a secondment, the Board had already considered the ultimate question that needed to be considered. As the Board rejected the Appellant's evidence about the separate Engagement Agreement, there could not have been a secondment. It is futile to consider the various decisions on secondment cited by Mr Ho. In any event, those decisions were decided on the basis of the factual circumstances in those particular cases.

63. For the above reasons, I answer Question (g) in the negative.

Conclusion

64. In conclusion, I answer Questions (a), (b), (c), (d) and (g) in the negative. The Appellant has decided not to seek an opinion in respect of Questions (e), (f), (h) and (i). Accordingly, I dismiss the appeal with costs to the Commissioner of Inland Revenue.

(Anthony To)
Deputy High Court Judge

Mr C M Ho, instructed by Messrs Choi & Liu, for the Appellant

Ms Jennifer Tsui, assigned by Department of Justice, for the Respondent