HCIA 2/2020
[2021] HKCFI 916

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
INLAND REVENUE APPEAL NO 2 OF 2020

BETWEEN

THE COMMISSIONER OF INLAND REVENUE Applicant

and

LO WA MING PATRICK Respondent

Before: Hon K Yeung J in Court
Date of Hearing: 10 February 2021
Date of Judgment: 14 April 2021

J U D G M E N T

This appeal

1. By Summons and "Statement of Grounds of Appeal and Reasons Why Leave Should Be Granted" (the "**Statement**") both dated 10 June 2020, the Commissioner of Inland Revenue (the "**CIR**") pursuant to section 69 of the Inland Revenue Ordinance, Cap 112 ("**IRO**") sought leave to appeal against decision D2/20 dated 11 May 2020 of the Board of Review (the "**Decision**" and the "**Board**") in Case No B/R 27/19.

2. On 14 July 2020, this Court granted the CIR leave to appeal on the two points of law (the "**2 Points of Law**") set out in the Statement, namely:

(a) the Board has erred in law by apportioning income to be exempted under section 8(1A)(c) of the IRO using the Board's Formula, which is inconsistent with the overarching provision for assessment of Salaries Tax under section 8(1)(a) of the IRO (the "**1st Point of Law**"); and

(b) the CIR's "*day in, day out*" formula as an apportionment method for calculating exempted income is not inconsistent with and/or in contradiction to and/or in any event does not lead to an arbitrary or unjust result under sections 8(1)(a) and 8(1A)(c) of the IRO (the "**2nd Point of Law**").

2. This is the hearing of the substantive appeal. Ms Katherine Chan appeared for the CIR. The Respondent appeared in person.

Relevant sections of the IRO

3. The following provisions of section 8 of the IRO are at the heart of this appeal:

"Charge of salaries tax

(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) subject to subsection (1AB), 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) subject to subsection (1C) and section 50AA, 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."

4. As observed by MacDougall J in *Commissioner of Inland Revenue v George Andrew Goepfert* [1987] HKLR 888, and in so far as relevant for the purpose of this appeal, the broad structure of section 8 of the IRO and the "charges" it imposes may be summarized as follows:

(a) The basic charge of salaries tax is imposed by section 8(1) (the "**Basic Charge**"). It is imposed on "*income arising in or derived from Hong Kong from any employment*";

(b) Once a taxpayer's salary falls within the basic charge, there is no provision for apportionment. The entire salary is subject to salaries tax wherever his services may have been rendered, subject only to any claim for relief:

(i) under section 8(1A)(b)(ii)[1] as read with section 8(1B)[2]; or

(ii) under section 8(1A)(c)[3];

(c) Section 8(1A)(a) is an extension of the basic charge (the "**Extended Charge**"). The extension focuses on the location where the services are provided. It catches income "*derived from services rendered in Hong Kong*", irrespective of whether it is "*income arising in or derived from Hong Kong from any employment*".

The background facts, and the parts of the Decision not under challenge

5. The facts may be briefly stated.

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1 ie the exclusion of income derived from services rendered by the taxpayer who renders outside Hong Kong all the services in connection with his employment.

2 ie the so-called "60 days rule", that no account shall be taken of services rendered in Hong Kong during visits not exceeding a total of 60 days in the basis period.

3 ie the exclusion of income derived from services rendered outside Hong Kong, and the satisfaction of sections 8(1A)(c)(i) and (ii)—see the 3 Requirements explained below.

6. The Respondent was an employee of CLP Power Hong Kong Ltd during the year of assessment 2014/2015 (the "**relevant Year of Assessment**"). He was seconded to CLP Engineering Ltd, then by CLP Engineering Ltd to Hong Kong Pumped Storage Development Co Ltd ("**PSDC**"), then by PSDC to Guangdong Pumped Storage Co Ltd ("**GPSC**"). In so far as relevant to the appeal, the secondment period was between 1 August 2014 and 31 March 2015 (the "**Secondment Period**"). The terms of his secondment was confirmed in a letter from PSDC of 28 July 2014. His work location was in Conghua in Guangdong Province. During the Secondment Period, he occasionally had to return to Hong Kong to work (attending meetings, reporting progress to the management, supporting work, receiving training, entertaining clients etc). The Respondent said that those activities were part of his work for GPSC[4]. He was entitled to statutory public holidays in the Mainland. He normally visited Hong Kong on Saturdays, Sundays, Mainland statutory holidays and during annual leave. Such stays were for holiday purposes wholly unconnected with his employment. There were 70 Saturdays and Sundays in total during the Secondment Period.

7. The Board found that:

(a) the whole of the Respondent's income in the relevant Year of Assessment came from CLP Power Hong Kong Ltd. It was a Hong Kong source. The place that the whole of the income came to him was Hong Kong. Section 8(1)(a) of the IRO (and hence the Basic Charge) applied to the whole of the Respondent's income during the relevant Year of Assessment[5];

(b) the exclusions under sections 8(1A)(b)(ii) read in conjunction with 8(1B) had no application. The reasons were that during the relevant Year of Assessment, the Respondent did render services in connection with his employment in Hong Kong, and that the services he rendered in Hong Kong exceeded a total of 60 days[6];

(c) the Respondent could not rely on section 8(1A)(c) to exclude the *whole* of his income during the Secondment Period, as he did render some services in Hong Kong. Differentiation had to be made between income derived by him from services rendered by him in the Mainland and income derived by him from services rendered by him in Hong Kong[7];

(d) the Respondent could however rely on section 8(1A)(c) to exclude *part* of his income during the Secondment Period[8];

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4 §14 of the Decision.
5 §23 of the Decision.
6 §24 of the Decision.
7 §25 of the Decision.
8 §27 of the Decision.

(e) as a result, it was necessary to conduct an exercise of apportionment[9];

(f) to qualify for exemption under section 8(1A)(c), three requirements (the "**3 Requirements**") would have to be met (taken from the plain language of the sub-section)[10]:

(i) that the income was derived from services rendered overseas;

(ii) that the income was by the law of that overseas territory chargeable to tax of substantially the same nature as salaries tax; and

(iii) that the CIR is satisfied that that person has paid tax of that nature in that territory in respect of the income.

(g) as accepted on behalf of the CIR before the Board, only the 1st of the 3 Requirements was in contention.

8. There is no appeal from any of the above. The appeal and the 2 Points of Law relate to the method and formula which the Board applied (or rejected) for the purpose of conducting the apportionment exercise.

The different methods and formulae

9. Before the Board, the CIR put forward the "*day in, day out*" method. That method, as explained on behalf of the CIR at §13 of the Statement, goes as follows:

> "…the correct method of apportionment should start with charging **all** of the Taxpayer's income during the [relevant Year of Assessment] from his employment to Salaries Tax under section 8(1)(a) of the IRO (since he was under a Hong Kong employment), then exclude his income qualifying for exemption under section 8(1A)(c) of the IRO by ascertaining and **exempting** days within the Secondment Period where the Taxpayer had earned income from services rendered outside of Hong Kong. Before the Board, the CIR suggested that '*an apportionment by reference to the number of days [the Taxpayer] stayed in the Mainland during the secondment period should be adopted,'* i.e. the so-called 'day in, day out' formula …"

10. Also relevant to the approach put forward by the CIR, and as recorded by the Board at §20 of the Decision, is the following submissions made on behalf of the CIR to the Board:

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9 §28 of the Decision.
10 §26 of the Decision.

> "… Given that there was no provision in the letter dated 28 July 2014 of PSDC distributing the Taxpayer's income into a part relating to the services rendered in the Mainland and a part relating to the services rendered in Hong Kong, an apportionment by reference to the number of days he stayed in the Mainland during the secondment period in the year [of] assessment should be adopted. Ms Chan also submitted that the approach the Assessor of the Revenue used in the recommendation to the Deputy Commissioner had taken into account the Taxpayer's needs to travel between Hong Kong and the Mainland and under this approach, the Taxpayer was not in fact prejudiced if he in fact travelled in the hours and for the travelling times he testified."

11. Hence, the "*day in, day out*" approach put forward by the CIR, in so far as I understand it, does take into account any contractual allocation, and it is only in the absence of such allocation that it may be applied.

12. The Board did not accept that formula. The Board expressed the views that;

(a) where the entirety of the income does not satisfy the 3 Requirements, it is a question of facts and evidence what part of the income does. The relevant question to ask is whether the taxpayer in question rendered any services in Hong Kong and derived income from such service[11];

(b) the "*day in, day out*" formula "*did not address the real issue*", and the adoption of that formula "*would have been arbitrary and led to injustice*"[12];

(c) both the CIR and the Respondent had in their respective submissions approached the matter of apportionment on a "*day in, day out*" basis based on the entry and exit records from the Immigration Department[13];

(d) in the light of the approach adopted by the parties on the issue of apportionment, little attention had been given by the parties on the finding of facts on the days within the Secondment Period on which the Respondent rendered services in Hong Kong and derived income from such service[14];

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11 §28 of the Decision.
12 §30 of the Decision.
13 §29 of the Decision.
14 §32 of the Decision.

(e) asking the relevant question stated by the Board (as set out in (a) above) "*necessarily means that the Saturdays, Sundays and PRC statutory holidays that the Taxpayer spent in Hong Kong should not be counted against his claim under section 8(1A)(c) of the IRO. These holidays would have been counted on a 'day in, day out' basis. This Board is of the view that this could not possibly be right and just*"[15].

13. In the end, the Board adopted the following method and formula (the "**Board's Formula**"):

(a) the Board first of all found from the evidence as a fact the number of days in each of the months within the Secondment Period when the Respondent rendered services in Hong Kong and derived income from such services ("**HK Days**");

(b) the Board noted the total number of days in each of those calendar months ("**Calendar Month Days**");

(c) the Board then worked out arithmetically the number of days in each of those months when the Respondent rendered services in the Mainland ("**Mainland Days**") by subtracting HK Days from Calendar Month Days (ie Calendar Month Days *minus* HK Days);

(d) the Board noted the total monthly income ("**Monthly Income**") the Respondent received for each of those months;

(e) The exempted income ("**Exempted Income**") for each month under section 8(1A)(c) was then worked out again arithmetically by adopting the following formula:

$$\text{Exempted Income} = \text{Monthly Income} \times \frac{\text{Mainland Days}}{\text{Calendar Month Days}}$$

The 2 Points of Law

14. The 1st Point of Law focuses upon the correctness of the Board's Formula. The 2nd Point of Law focuses upon the correctness of the "*day in, day out*" formula put forward by the CIR. They are in fact closely related.

Parties' submissions

15. Ms Chan's submissions may be summarized as follows:

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[15] §33 of the Decision.

(a) Giving the Board's finding that section 8(1)(a) of the IRO applied to the whole of the Respondent's income in the relevant Year of Assessment, the Board should have started with the Basic Charge;

(b) With the Basic Charge as the starting point, the Board should have considered that all of the Respondent's relevant income was subject to salaries tax, and that only those which qualify for exclusion under section 8(1A)(c) can be excluded;

(c) If the Board had correctly conducted the apportionment exercise:

" it would not have erroneously included Saturdays, Sundays and [Mainland] statutory holidays [which the Respondent] spent in Hong Kong during the Secondment Period as part of the exempted income under section 8(1A)(c). This calculation is problematic as it had in fact **included** the Taxpayer's income derived from his services rendered in Hong Kong for assessment only." [16] (Ms Chan's original **emphasis**)

(d) As the Respondent was paid an annual salary with paid annual and sick leave, his daily salary can be apportioned as 1/365th of his annual salary. The whole of the income in the Secondment Period should be subject to salaries save those exempted under section 8(1A)(c). The adoption of the "*day in, day out*" formula is reasonable;

(e) The "*day in, day out*" formula will not lead to arbitrary and/or unjust result, is in line with the principles of assessment of Salaries Tax under sections 8(1)(a) and 8(1A)(c) of the IRO and is supported by "*well-established overseas authorities*"[17], which the Board has erred in rejecting.

16. The Respondent has filed no written submissions. In the course of the hearing, he made a brief submission asserting that the "*day in, day out*" formula is unfair. Beyond that, he was not able to contribute further to the discussion. This is not expressed as any criticism, given the nature of the legal issues and that the Respondent is acting in person. The result however does mean that this Court when considering the 2 Points of Law is handicapped by the absence of any counter-submissions from the Respondent.

17. I record also that no submissions have been made to this Court on behalf of the CIR on any double taxation agreement between the Mainland and Hong Kong or any practice which the Inland Revenue Department or the Mainland State Taxation Administration may have adopted in relation to the apportionment exercise under

[16] §10 of Ms Chan's written submissions.
[17] §20 of her written submissions.

section 8(1A)(c). Ms Chan's submissions are based solely on the way she submits the IRO (and in particular section 8 thereof) should be construed.

Absence of binding authorities

18. I have been informed by Ms Chan that there are no direct decided decisions on the 2 Points of Law at the Court of First Instance level or above.

19. I summarize below those decisions that have been cited to me by Ms Chan.

20. I have referred to *Goepfert* above. *Goepfert* is not directly on point:

(a) That case concerns primarily section 8(1A)(b) of the IRO;

(b) MacDougall J held, on a proper interpretation of section 8 of the IRO, that:

(i) given the Board's findings of facts, the relevant income of the respondent in that case did not fall within the Basic Charge;

(ii) the respondent there was only liable to pay salaries tax on the income derived from the services he actually rendered in Hong Kong (ie the Extended Charge);

(iii) the respondent was not liable to pay salaries tax on the income derived from the services which he had rendered outside Hong Kong (41 days in total). It was in that context where MacDougall J observed at 903C that "*[i]n other words his income for salaries tax purposes is apportioned on a 'time in, time out basis'* ";

(c) There was no discussion in that case about any apportionment exercise for the purpose of section 8(1A)(c). There was in any event no discussion as to what that so-called "*time in, time out basis*" meant.

21. The Board at various places of the Decision referred to the decision of an earlier and differently constituted Board of Review (the "**D24/17 Board**") in D24/17 33 IRBRD 526 (7 February 2018) ("**D24/17**"). In D24/17:

(a) the D24/17 Board found on the evidence, despite the taxpayer's case that she rendered her services exclusively in Shanghai, that the relevant employment of the taxpayer was caught by the Basic Charge;

(b) the Assessor found out from the Immigration Department that the taxpayer was in Hong Kong for 82 days during the relevant assessment period. The Assessor then adopted a '*day out*' formula to apportion the sum for exclusion from her income. The parts of the taxpayer's salary and bonus apportioned and attributed to those 82 days were hence assessed for salaries tax[18];

(c) the D24/17 Board observed[19] that the Assessor had confused the "60 days rule" with the "*day in, day out*" formula. It further observed that in *Goepfert*, the court approved a "*day in, day out*" formula in relation to the Extended Charge, but made no reference to any such apportionment in the context of sections 8(1A)(b) and 8(1A)(c) of the IRO.

(d) the D24/17 Board considered the English authorities relied upon by the CIR, namely *Varnam v Deeble* [1985] STC 308, CA; *Coxon v Williams* [1988] STC 593 and *Leonard v Blanchard* [1993] STC 259, CA. The D24/17 Board expressed the views that these cases were concerned about fiscal provisions in England, which were not comparable to the exemption in section 8(1A)(c) of the IRO[20];

(e) the D24/17 Board considered an earlier Board of Review decision (BR 49/08) wherein the earlier Board accepted the "*day in, day out*" formula. The D24/17 Board declined to follow BR 49/08 because the reasoning in BR 49/08 was in its view not clear;

(f) the D24/17 Board expressed further the following views on the "*day in, day out*" formula if applied to an apportionment exercise in the context of section 8(1A)(c) of the IRO:

" 75. … We take the view that such apportionment was arbitrary and unfair and it required the Appellant to pay tax on income on which she had already paid IIT in the Mainland …

…

79. In our view the correct reasoning should be as follows:

…

[18] §41.
[19] §72.
[20] §73.

> (4) None of the 3 [Requirements] has any correlation with the number of days the Appellant may fortuitously happen to be in or out of Hong Kong. The relevant enquiry is whether she rendered her services inside or outside Hong Kong, and if so, whether her income or any portion thereof was derived from services inside or outside Hong Kong (i.e. requirement (i)). This is a very different enquiry from an arbitrary 'day in day out' formula.
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> 80. Apportionment does not depend on such an arbitrary formula. Rather apportionment becomes a live issue if the entirety of the income does not satisfy the [3 Requirements]. It is then a question of facts and evidence what part of the income satisfies the [3 Requirements] …
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> 81. … the Assessor had a duty to direct his mind to the [3 Requirements]. Instead of applying an arbitrary 'day in day out' formula, the Assessor should have investigated requirement (i). Instead of asking how many days the Appellant was physically in Hong Kong, the pertinent question should be whether the Appellant rendered any services in Hong Kong and derived income from such service."

(g) The D24/17 Board accepted the taxpayer's evidence that she came back to Hong Kong during those 82 days predominantly for personal reasons, and that in so far as any "work" which she had done whilst in Hong Kong was concerned, the work was minimal and peripheral and had no impact on her salary and bonus in any way[21]. The D24/17 Board found that the 2 sums concerned (the salary and bonus) satisfied the 3 Requirements and should be excluded from salaries tax. Because of that, no apportionment was made.

22. At §18 of her written submissions Ms Chan submits that the D24/17 Board did not reject the "*day in, day out*" formula, but made its findings based on the evidence put forward by the taxpayer in that case.

23. Whilst I accept that the D24/17 Board ultimately did not find it necessary to conduct any apportionment exercise, it did express adverse views on the "*day in, day out*" formula (as cited above). Whether it indeed expressly rejected it is neither here nor there.

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[21] §§42 and 84.

24. However, the decision of the D24/17 Board is not binding on this Court. I will consider below the 2 Points of Law independently to see whether I agree with the D24/17 Board.

25. I have mentioned above *Varnam v Deeble*, *Coxon v Williams* and *Leonard v Blanchard*, which were cited before the D24/17 Board. Before this Court, Ms Chan relies on those same cases.

26. In respect of *Varnam v Deeble*:

(a) In two assessment years, the taxpayer's duties involved travel on business outside the United Kingdom;

(b) Under paragraph 2(1) of Schedule 7 to the Finance Act 1977 ("**para 2(1)**", "**Sch 7**" and the "**Finance Act**" as appropriate), relief shall be given to emoluments "*attributable to duties performed outside the United Kingdom*";

(c) Under that paragraph, relief was calculated with reference to "*qualifying days*", which was defined as "*a day of absence from the United Kingdom ... which is substantially devoted to the performance outside the United Kingdom of the duties of that employment ...*"[22];

(d) There was no dispute that the number of "*qualifying days*" spent by the taxpayer amounted to 33 in 1977-78 and 34 in 1978-79;

(e) The taxpayer's employment contract was silent as to what portions of his salaries was attributable to his overseas duties;

(f) Sch 7 contained no express method of allocation;

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[22] The relevant parts of para 2 of Sch 7 to the Finance Act as set out at §§97-98 of the judgement in *Varnam v Deeble* are as follows:

" (1) Where in any year of assessment—

(a) the duties of an employment are performed wholly or partly outside the United Kingdom; and

(b) the number of days in that year which are qualifying days in relation to the employment (together with any which are qualifying days in relation to other employments) amounts to at least 30,

then, in charging tax under Case I of Schedule E on the amount of the emoluments from the employment attributable to duties performed outside the United Kingdom in that year, there shall be allowed a deduction equal to one quarter of that amount.

(2) For the purposes of this paragraph a qualifying day in relation to an employment is a day of absence from the United Kingdom—

(a) which is substantially devoted to the performance outside the United Kingdom of the duties of that employment or of that and other employments ...".

(g) The disputed issue was therefore what fraction of the taxpayer's emoluments should be attributed to those 33 and 34 "*qualifying days*";

(h) The Crown contended that they should be calculated on a time-apportionment basis;

(i) The taxpayer contended that the attribution should not have been calculated on a time-apportionment basis, but should be made by reference to the nature of the duties (by taking into account the time devoted to, and the nature of, the taxpayer's foreign duties);

(j) Browne-Wilkinson LJ observed [23] that whilst the words "*attributable to duties performed outside the United Kingdom*" in isolation are capable of being interpreted either way, he was of the view that the time-apportionment basis was the correct interpretation. The Lord Justice explained that:

"… when read in context with regard to the practicalities of the matter, I agree with the judge that the right construction is to attribute the emoluments on a time apportionment basis. The statutory words require an attribution to be made on some basis and, in the absence of other indications, in my judgment the attribution falls to be made by reference to the taxpayer's contractual right to emoluments for the work performed. If the contract specifically allocates part of the remuneration to the overseas duties, then for the purposes of para 2(1) that part will be the emoluments attributable to such duties, subject to the ceiling provisions of para 4. If, as in the present case, there is no express contractual allocation, the contractual right of the employee to remuneration would be the remuneration for the days on which such duties were performed, the total remuneration being apportioned on a time basis under the Apportionment Act 1870."

(k) On the "*practicalities of the matter*", Browne-Wilkinson LJ observed[24] that:

" If such attribution were to be made on the basis contended for by the taxpayer, in the normal case such as this where there is no contractual allocation of part of the salary to overseas duties, each year there would have to be an inquiry into the nature and responsibilities not only of the overseas duties but also of the United Kingdom duties of the taxpayer. The relevant facts are not known to the Revenue. The amount of the relief would be

[23] At p 312 e-g.
[24] P 312 g-j.

wholly uncertain and would depend on an *ex post facto* value judgment. Although, as counsel for the taxpayer pointed out, there are provisions of the taxing statutes which do require such a value judgment to be made (see, for example, s 32 of the 1977 Act) it is contrary to the normal approach of a taxing statute which, so far as possible, aims to make the amount of tax assessable by reference to objective criteria."

(l) In the end, the Lord Justice concluded[25] that:

"… the taxpayer is entitled to relief under para 2(1) in respect of the number of days spent outside the United Kingdom in the performance of his duties. The taxpayer only claimed 33 days in 1977-78 and 34 days in 1978-79. Therefore, the eligible emoluments are 33/365 and 34/365 of the emoluments for those years respectively."

27. In respect of *Coxon v Williams*:

(a) The Court was similarly concerned with para 2(1) of Sch 7 to the Finance Act;

(b) In that case, the taxpayer under his contract of employment had to work 36¼ hours per week. He was entitled to five weeks of holiday in a year during which normal remuneration was payable. On leaving his employer's service, the taxpayer was entitled to receive payment for any holiday outstanding, and in calculating payment for the holidays, one day's pay was to be equal to his annual basic salary divided by 260. During the year 1981-82, the taxpayer's "*qualifying days*" of absence from the United Kingdom in relation to his employment for the purposes of para 2(1) of Sch 7 to the Finance Act amounted to 65. The taxpayer was assessed to income tax for that year on the basis that the amount of the "emoluments attributable to duties performed outside the United Kingdom" under para 2(1) of Sch 7 to the Finance Act was his salary for that year multiplied by the fraction 65/365. The taxpayer appealed contending that since he was contractually obliged to work no more than 235 days in that year, the appropriate denominator of the fraction should be 235. The commissioner upheld the assessment and the taxpayer appealed;

(c) Knnox J applied *Varnam* and affirmed the proposition that in applying para 2(1) of Sch 7 to the Finance Act, a time apportionment basis is correct unless the relevant contract provides a different allocation of remuneration than a time

[25] P 313 c-d.

apportionment one[26]. The terms in the taxpayer's contract adopting 260 days for the purpose of calculating the taxpayer's holidays were simply administrative provisions, and did not displace the time apportionment basis which remained applicable.

28. In respect of *Leonard v Blanchard*:

(a) The Court was also concerned with para 2(1) of Sch 7 to the Finance Act and section 184(1) of the Income and Corporation Taxes Act 1970;

(b) One preliminary question raised by the parties was whether, when deciding the emolument "*attributable to duties performed outside the United Kingdom*", the denominator of the fraction to be used should be the number of days in the calendar year (365) (as the Crown contended), or whether it should be total number of days during that calendar year when the taxpayer performed duties (eg 365 less the number of days off) (as the taxpayer contended);

(c) On that preliminary question, Nourse LJ held that it should be 365. The reasons were as follows:

"Viewing the question apart from authority, I observe that it arises because the words of para 2(1) do not tell you with what amount the amount of the emoluments attributable to duties performed outside the United Kingdom is to be compared. [The taxpayer's] submissions require the comparison to be made with the amount of the emoluments attributable to duties performed within the United Kingdom, so that the amount of emoluments attributable to periods when no duties are performed are to be left out of account. But in a case where the emoluments are paid under a contract of employment which differentiates neither between the locations where duties are performed nor between days on which they are or are not performed I can see no reason in logic or common sense for attributing to Parliament any such intention as [the taxpayer] has contended for. There is no ground for holding that the salary is payable on any basis other than that of 1/365th of the whole for each and every day of the year. The position is even clearer where, as here, the contract expressly provides for paid holiday and paid absence on account of sickness or disability. It is put beyond doubt by the material provisions of the Apportionment Act 1870, whose effect was set out in *Coxon v Williams* (at 595-596). But I incline to think that the position would have been the same without those provisions, on the simple

[26] P 599g of the Judgment.

ground that no other basis of apportionment could reasonably have been suggested."

Discussion

29. Under section 8 of the IRO, section 8(1) imposes the Basic Charge. Subject to the provisions of the IRO, that Basic Charge is on every person "*in respect of his income arising in or derived from Hong Kong from any office or employment of profit and pension*". It is imposed on income from a Hong Kong employment.

30. Section 8(1A) of the IRO contains provisions governing what are to be included in or excluded from "*income arising in or derived from Hong Kong from any employment*". Section 8(1A) itself should be read in conjunction with the 60 days rule contained in section 8(1B).

31. Section 8(1A)(a) of the IRO is an inclusion. As explained in *Goepfert*, section 8(1A)(a) imposes the Extended Charge. It relates to non-Hong Kong employment, and charges income derived from services rendered in Hong Kong.

32. In contrast with sections 8(1A)(a), 8(1A)(b) and 8(1A)(c) provide separately for two exclusions.

33. So, in the case of a Hong Kong employment, the Basic Charge covers all of the taxpayer's income, subject only to those two exclusions under sections 8(1A)(b) and 8(1A)(c).

34. I accept Ms Chan's submission that in the case of a Hong Kong Employment, the starting position is the Basic Charge. It is from there where one then applies the provisions of the IRO to ascertain whether any part of the charged income is excluded.

35. The exclusion provided for in section 8(1A)(c) is a "relief from double taxation". That is what section 50AA stipulates.

36. If all the income of a taxpayer within an assessment year qualifies for relief as an exclusion under section 8(1A)(c), no question of apportionment arises.

37. However, in a case where only part of the taxpayer's income for an assessment year qualifies for relief as an exclusion in section 8(1A)(c), it becomes necessary to ascertain what part of the taxpayer's income does and what part does not.

38. More precisely, the purpose of the exercise of apportionment is to ascertain what part of the taxpayer's income satisfies all 3 Requirements, and what part not.

39. The 2nd and 3rd of the 3 Requirements normally do not pose much difficulties. The fiscal system of the territory concerned, and whether tax has been paid in that territory, are factual, and can easily be proved.

40. The difficulty lies with the 1st of the 3 Requirements, ie to ascertain the "*income derived … from services rendered ... outside Hong Kong*".

41. Section 8(1A)(c) is silent as to what method or test is to be applied when the 1st of the 3 Requirements is considered.

42. The issue we are facing is not dissimilar to the question faced by the English Courts in *Varnam*, *Coxon* and *Leonard*, which question arose, as explained by Nourse LJ in *Leonard*, "*because the words of para 2(1) do not tell you with what amount the amount of the emoluments attributable to duties performed outside the United Kingdom is to be compared*".

43. The English answer, as can be gathered from the three English authorities, may be summarized as follows:

(a) the amount of deduction is to be worked out with reference to the concept of "*qualifying days*" defined as "*a day of absence from the United Kingdom ... which is substantially devoted to the performance outside the United Kingdom of the duties of that employment …*";

(b) whether a day is a "*qualifying day*" is a question of fact to be decided in accordance with the stipulated definition;

(c) in working out the emoluments attributable to duties performed outside the United Kingdom:

(i) the terms of the employment contract should be noted to see if it contains any contractual allocation;

(ii) unless there is such contractual allocation, a time apportionment basis is the correct one;

(iii) an apportionment based on the *nature* of the overseas duties, having paid regard to "*the practicalities of the matter*", is not the correct approach;

(iv) when the time apportionment basis is adopted:

(1) the attribution is to be worked out by multiplying the total annual income with a fraction;

(2) the numerator of the fraction is the total number of "*qualifying days*" in the assessment year;

(3) the denominator of the fraction is the total number of days in that calendar year.

44. I can see reasons for the adoption of the time apportionment basis as the *prima facie* basis in England:

(a) To start with, as observed by Browne-Wilkinson in *Varnam*, the statutory language of para 2 of Sch 7 to the Finance Act allows that interpretation;

(b) "*Qualifying days*" are statutorily defined;

(c) Importantly, that definition is linked to the performance of overseas duties by the taxpayer. To qualify, that day will have to have been "*substantially devoted to the performance outside the United Kingdom of the duties of that employment*";

(d) The definition provides statutory parameters for the total number of "*qualifying days*" to be factually ascertained. As can be seen from the English authorities cited to me, the numbers of "*qualifying days*" (and hence the value of the numerator of the fraction) had been established in the light of the statutory definition. What was in dispute related to the value of the denominator to be adopted.;

(e) Once ascertained, the number of "*qualifying days*" offer a good starting point for the application of the time basis (the proportion of the number of "*qualifying days*" to the total number of calendar days);

(f) It is also practical, and allows the amount of tax to be assessable by reference to objective criteria.

45. The position in England under the Finance Act however has to be contrasted with the position in Hong Kong under the IRO:

(a) The IRO does not provide for the concept of or similar to "*qualifying days*". Section 8(1A)(c) simply "*excludes income derived by a person from services rendered by him in any territory outside Hong Kong*";

(b) I have highlighted the fact that the definition of "*qualifying days*" under the Finance Act is linked to the performance of overseas duties by the taxpayer. The use of the total number of "*qualifying days*" as the numerator of the fraction should be appreciated against this background;

(c) In Hong Kong, and in the absence of any statutory concept of or similar to "*qualifying days*", the CIR in the case of the Respondent merely adopted the Respondent's travel records kept by the Immigration Department and, having taken into account the travel time, worked out the total number of days that the Respondent was in the Mainland during the Secondment Period. That total number of days was then used as the numerator of the fraction for the purpose of calculating the amount of exclusion under section 8(1A)(c);

(d) However, unlike a "*qualifying day*" which is statutorily defined to be linked to the performance of overseas duties, the mere physical presence of the Respondent whether in the Mainland or in Hong Kong is not;

(e) The plain language of section 8(1A)(c) (and hence the 3 Requirements taken therefrom) does not require or justify a test based only upon the physical presence of the Respondent in the Mainland or Hong Kong during the Secondment Period;

(f) The application of the "*day in, day out*" approach would lead to anomalies. All other matters assumed, if the Respondent had decided to spend any weekends or Mainland statutory holidays in the Mainland, those days *would be counted* in favour of exclusion under the "*day in, day out*" approach (because the immigration records show that the Respondent was in the Mainland, as if mere presence in the Mainland can be equated to the rendering of services under his secondment); but if so happened, the Respondent had decided to come back to Hong Kong to rest over those same weekends and Mainland statutory holidays, those days would *not* be so counted. This in my view cannot be correct, and is not a principled approach to the matter. This Court in fact canvassed with Ms Chan in the course of the hearing such anomalies. I received no submissions as to how those anomalies may be explained;

(g) The position of weekends and Mainland statutory holidays warrants special discussion:

(i) Ms Chan, relying on *Leonard*, submits[27] that in view of the fact the Respondent was paid by his employer on an annual salary with paid annual and sick leave, his daily salary can be apportioned as 1/365th of his annual salary;

[27] §§14 and 15 of her written submissions.

(ii) I accept those submissions;

(iii) So viewed, all the weekends and Mainland statutory holidays during the Secondment Period should be apportioned daily income;

(iv) Ms Chan further submits [28] that the whole of the Respondent's income in the Secondment Period, including the income apportioned to weekends and Mainland statutory holidays, was caught by the Basic Charge;

(v) But even so, the analysis does not end there. The following issue will still have to be considered: whether the part of the Respondent's income apportioned to weekends and Mainland statutory holidays was income "*derived by [the Respondent] from services rendered by him in any territory outside Hong Kong*" so as to satisfy the 1st of the 3 Requirements, so that the exclusion under section 8(1A)(c) applies. In my view, it was. Even though the Respondent did not actually render any services during those days, those days are his rest days for the work he rendered, and the apportioned income should as a matter of principle be regarded as having been derived from the services the Respondent otherwise provided in the Mainland during working days;

(vi) I do not believe section 8(1A)(c) should be so narrowly construed as to include only those incomes allocated to those days in which a taxpayer actually works. I do not believe that is the CIR's position. Otherwise, all income allocated to weekends and Mainland statutory holidays during which the Respondent did not actually render service ought not as a matter of principle qualify for exclusion, irrespective of where the taxpayer physically were. That would be inconsistent with even the CIR's own position[29];

(vii) In my view, the principled approach is that the part of the Respondent's income allocated to weekends and Mainland statutory holidays should qualify for exclusion for the purpose of section 8(1A)(c), irrespective of where the Respondent physically was over those weekends and Mainland statutory holidays;

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[28] §15 of her written submissions.

[29] See §§15 and 45(f) above.

(h) I do not accept Ms Chan's submission that the "*day in, day out*" approach is supported by "*well-established overseas authorities*". In my view, the CIR's reliance upon the 3 English authorities is misplaced. They were decided in the context of para 2 of Sch 7 to the Finance Act which are, given the performance-linked definition of "*qualifying days*", fundamentally different from section 8 of the IRO. I am of the view that those 3 cases, properly understood, in fact illustrate the arbitrary nature of the "*day in, day out*" approach when applied in the Hong Kong context.

46. I have considered what inference can be drawn from the fact that travel records show that a taxpayer was on a particular day physically in a territory outside Hong Kong. Without more, no inference can be drawn that that taxpayer rendered services on that day and derived income from such services. That much is clear. However, in appropriate case, for example in the case of a contractual secondment of a Hong Kong resident, which the Respondent's case was, and in the absence of any contrary evidence, the fact that the taxpayer was on a particular day within the Secondment Period in the territory where he had been seconded to *might* be sufficient to support the inference that he did on that particular day render services there under his secondment. Much is however dependent on the primary facts, as the drawing of inferences always is. The possibility that such an inference may be drawn does not give rise to any sort of presumption. Nor does such possibility necessarily support any apportionment formula—like the "*time in, time out*" formula which the CIR is advocating.

47. Similar observations may be made on records showing that a taxpayer is not within the territories where he has been seconded to. It is a question of evidence as to what inference can be drawn from the same. All evidence will have to be considered. I repeat my observations above on weekends and Mainland statutory holidays.

48. In my view:

(a) the adoption for the purpose of section 8(1A)(c) of the IRO "*an apportionment by reference to the number of days [the Taxpayer] stayed in the Mainland during the secondment period should be adopted, i.e. the so-called 'day in, day out' formula*"[30], involving as it does the use only of travel records to work out the numerator of the fraction for the purpose of making any time apportionment, is arbitrary and is inconsistent with the plain language of section 8(1A)(c). In this regard I agree with the D24/17 Board and the Board;

(b) when deciding any apportionment under section 8(1A)(c), it is a question of facts and evidence as to what part of the income

[30] See again §13 of the Statement.

satisfies the 3 Requirements. I agree again in this regard with the D24/17 Board and the Board;

(c) I have however some observations on what the D24/17 Board has stated at §81 of its decision:

(i) The pertinent question in respect of requirement (i) is whether the income was derived from services rendered overseas;

(ii) At §81 of its decision, the D24/17 Board observed that "*the pertinent question should be whether the Appellant rendered any services in Hong Kong and derived income from such service*";

(iii) I do not understand the D24/17 Board as meaning there that when deciding requirement (i), the methodology has to be a reverse one, ie starting with the question of whether any service was rendered in Hong Kong so as to work backwards to decide whether the income was derived from services rendered overseas;

(iv) In as far as I see it, and in context, the D24/17 Board was there simply addressing the application by the Assessor of the '*day in, day out*' formula to the 82 days whilst the taxpayer was shown by the immigration records to be in Hong Kong. In respect of those 82 days, the D24/17 Board was of the view that rather than asking how many days the taxpayer was physically in Hong Kong, the more pertinent question was whether the Appellant there "*rendered any services in Hong Kong*";

(d) when deciding the apportionment, regard can be given to any contractual attribution;

(e) time apportionment is not impermissible if the facts and evidence justify its adoption. The value of the numerator of the fraction should be decided from the facts and evidence. In appropriate cases, inference may be drawn from travel records of the taxpayer;

(f) In the case of secondment from Hong Kong to the Mainland, and in relation to income apportioned to weekends and statutory holidays in the Mainland, the application of the CIR's "*day in, day out*" formula will in particular lead to anomalies. It is not appropriate for this Court to over-generalize, but in the instant case, I am of the view that the part of the Respondent's income allocated to weekends and Mainland statutory holidays should

qualify for exclusion for the purpose of section 8(1A)(c) , irrespective of where the Respondent physically happened to have been;

(g) The denominator of the fraction should be the number of calendar days (in any given month or year depending on the approach);

(h) The resultant fraction of the total monthly or annual income (as the case may be) will be the exclusion permitted by section 8(1A)(c) .

Back to the 2 Points of Law

49. I come back to the 2 Points of Law.

50. For the reasons set out and discussed above, I answer the 2nd Point of Law as framed in the negative. So that there be no misunderstanding, my view is that the CIR's "*day in, day out*" formula as an apportionment method for calculating exempted income *is* inconsistent with, *is* in contradiction to, and in any event does lead to an arbitrary or unjust result under sections 8(1)(a) and 8(1A)(c) of the IRO.

51. In respect of the 1st Point of Law:

(a) in my view, the Board's approach is not inconsistent with the overarching provision for assessment of Salaries Tax under section 8(1)(a) of the IRO;
(b) the approach adopted by the Board also results in the Respondent's income apportioned to weekends and Mainland statutory holidays being qualified for exclusion, which I regard as correct;
(c) I however make the same observations on the Board's approach as I have in relation to §81 of the D24/17 Board's decision. Whilst the approach is appropriate on the facts before the Board, it does not mean that the methodology is necessarily a reverse one;
(d) I answer the 1st Point of Law as framed also in the negative.

Conclusions

52. In respect of the 1st Point of Law, and in the sense as explained in §51 above, I answer the same in the negative.

53. In respect of the 2nd Point of Law, I answer the same in the negative.

54. Accordingly, I dismiss the appeal.

Costs

55. I make a costs order *nisi* that there be no order as to costs.

(Keith Yeung)
Judge of the Court of First Instance
High Court

Ms Katherine Chan, instructed by Department of Justice,
for the Commissioner of Inland Revenue

The Respondent, unrepresented, appeared in person