

**Case No. D3/23**

**Salaries tax** – appellant entering into ‘dual employment’ arrangement with companies in different jurisdictions – whether income for service rendered outside Hong Kong exempted from salaries tax – source of income – apportionment approach to be adopted in determining extent of service rendered outside Hong Kong – sections 8(1), 8(1A)(c), 9(1), 61, 61A and 68(4) of Inland Revenue Ordinance (Chapter 112) (**‘Ordinance’**)

Panel: Hau Pak Sun (chairman), Chan Wai Kam Caroline and Chiu Chi Kong.

Dates of hearing: 24 & 26 March 2021.

Date of decision: 5 June 2023.

Company D was a listed company in Hong Kong. At the relevant time, D and its subsidiary (**‘Group’**) had two principal businesses, namely: (a) Industry V and Industry X business in Macau; and (b) construction materials in Hong Kong, Macau and the mainland China.

The appellant was employed by Company J in 2004 to restructure Company J’s Macau business and inject it into the Group. In July 2005, Company J successfully injected the Macau business into Company D. After that, the appellant entered into an employment agreement with Company G (whose principal place of business was in Hong Kong and was a vehicle of the Group to engage senior executives) (**‘2005 HK Agreement’**) to support and service the Hong Kong administration of Company D and the Industry V business in Macau. It was an express term of the 2005 HK Agreement that the appellant’s principal place of work in Hong Kong would be designated by Company G, and the appellant would also be required to work at other locations in or outside Hong Kong. From 2005 onwards, the appellant had been travelling to Macau to provide his service.

In 2009, to ensure compliance with Macau legal requirement, the Group decided that some senior employees would also be employed by Company H (a service company of the Group incorporated in Macau) so that they could work lawfully in Macau. On 1 April 2009, the appellant entered into a ‘dual employment’ with Company G and Company H by way of a letter (**‘2009 Letter’**), under which the appellant’s employment terms with Company G was revised, and that the secondment with Company H would take effect on that day. Further and on the same day, the appellant entered into employment agreements with Company G (**‘2009 HK Agreement’**) and Company H (**‘2009 Macau Agreement’**) which were respectively governed by Hong Kong and Macau laws. Under the 2009 HK Agreement, the appellant’s scope of work and responsibility as well as principal place of work in Hong Kong should be determined and designated by Company G, which could relocate or reposition the appellant to other departments within the Group and other locations in or outside Hong Kong. Under the 2009 Macau Agreement, it was an express term that the appellant should not undertake any other business or become employee of

other company. The appellant's employment arrangement with the Group was further adjusted in 2012. By a letter of 22 March 2012 ('**2012 Letter**'), Company G informed the appellant that he would commit about 45% of his time and effort to Company H effective from 1 March 2012.

In relation to the years of assessment 2009/10, 2010/11, 2012/13 and 2013/14, the Commissioner determined that the appellant's entire income was derived from his employment with Company G and should be chargeable to salaries tax (subject to exemption under section 8(1A)(c) of the Ordinance) and rejected the appellant's claim that he held a separate and distinct employment with Company H. In computing the amount of the appellant's income attributable to his service rendered in Macau for exemption purpose, the Commissioner adopted a time-in-time-out approach ('**TITO Approach**') and considered counting the number of days that the appellant stayed in Macau to be a fair and reasonable basis.

The appellant appealed against the Commissioner's decision. The issue on appeal was whether the appellant would be considered as having two employments (in two jurisdictions) and, if the appellant was considered to have only one employment located in Hong Kong, whether the TITO Approach should be adopted for the purpose of exemption under section 8(1A)(c). The appellant also disputed all incomes paid by Company H, including salary, bonuses and share option gain.

**Held:**

***Applicable principles***

1. Under section 8(1A)(c), certain income was exempted from the charge to salaries tax, namely, income derived from services rendered in any territory outside Hong Kong where, (a) by the law of the territory where the services were rendered, the income was chargeable to tax of substantially the same nature as salaries tax under the Ordinance and (b) the Commissioner was satisfied that that person had, by deduction or otherwise, paid tax of that nature in that territory in respect of the income.
2. In determining source of income, the locality was not the place where the activities of the employee were exercised but the place either where the contract for payment was deemed to have a locality or where the payments for employment were made. Thus, where the source of income was from an employment, the locality was the place where the contract for payment was deemed to have a locality. In most cases, the place of payment was the locality of the contract. This must include consideration as to the place where the employee was to be paid, where the contract of employment was negotiated and entered into and whether the employer was resident in the jurisdiction. But none of these factors are determinative. If the employer was not resident in Hong Kong but came to Hong Kong to recruit employees to work exclusively overseas, the locality of contract was not in

Hong Kong. In determining the source of income, the Commissioner was entitled to scrutinize all evidence relevant to the matter and was not bound to accept as conclusive any claim made by the employee (Lee Hung Kwong v Commissioner of Inland Revenue [2005] 4 HKLRD 80 and Commissioner of Inland Revenue v George Andrew Goepfert [1987] 2 HKTC 210 considered).

3. 'Secondment' was a period of temporary employment at the end of which the employee returned to his general employment. Depending on the circumstances, a secondment might be based on a contract of service made between the temporary employer and the employee with the consent of the general employer, or it might 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 employee. A secondment did not necessarily change the location of employment, which depended on the terms of the secondment and in particular the source of income (Lee Hung Kwong v Commissioner of Inland Revenue [2005] 4 HKLRD 80 considered).

***Source of income***

4. In determining source of income, the 'totality' of facts would have to be considered. Although the Group's expanding business was in Macau, the Group was part of Company D which was incorporated and with registered office in Hong Kong. Prior to 1 April 2009, the appellant was at all relevant times employed by Company G and that his entire income would be subject to salaries tax in Hong Kong, notwithstanding that he was required to travel to Macau for business. The entering of the 2009 HK Agreement and 2009 Macau Agreement did not create a fundamental change to the job duties of the appellant. In the premise, there was no change in the appellant's source of income, which was at all material times in Hong Kong (Lee Hung Kwong v Commissioner of Inland Revenue [2005] 4 HKLRD 80 and D43/94, IRBRD, vol 9, 278 considered).
5. Notwithstanding the place of payment under the 2009 Macau Agreement was in Macau, this factor was only one of the factors in considering the totality of all the factors. In this regard, a secondment did not necessarily change the location of employment. At all material times, the appellant only had one employment in Hong Kong for the purposes of assessment of salaries tax. Alternatively, the appellant has failed to discharge his onus of proving that the Commissioner's determination that his entire income was derived from his employment with Company G was wrong. In the premises, the appellant's entire income was derived from his employment with Company G and should be chargeable to salaries tax in Hong Kong, subject to exemption under section 8(1A)(c) (Lee Hung Kwong v Commissioner of Inland Revenue [2005] 4 HKLRD 80 and D43/94, IRBRD, vol 9, 278 considered).

***Apportionment approach***

6. In the absence of contractual allocation, the time apportionment approach has been consistently applied in Hong Kong to determine the extent of a taxpayer's service rendered outside Hong Kong. In the absence of other indications, the basis could be made by reference to the taxpayer's contractual right to emoluments for the work performed (Varnam (Inspector of Taxes) v Deeble [1985] STC 308 and Platten (Inspector of Taxes) v Brown [1986] STC 514 considered).
7. The appellant's contractual arrangements after 1 April 2009 regulated the amount of time he had to devote to and attributed remuneration to his employment in Macau. After all, the test was whether the contract itself provided for how the emoluments were apportioned, and if so and in the absence of other indications, the apportionment could first be made on this basis. In this regard, the appellant's movement records of his stay in Macau illustrated that the appellant could have indeed spent his time in Macau which matched (if not exceeding) closer to the 'guestimate' in the 2009 Letter and 2012 Letter, which represented a genuine estimation of the appellant's working time spent in Macau. It was unnecessary to consider whether TITO Approach was a correct one.

***Disputed Sum***

8. In relation to the disputed salary, (a) from 1 April 2009 up to 29 February 2012, the appellant's salary attributable to services rendered in Macau should be adjusted to 30% of his total salary and housing allowance paid by Company G and Company H; and (b) from 1 March 2012 onwards, the appellant's salary attributable to services rendered in Macau should be adjusted to 45% of his total salary and housing allowance paid by Company G and Company H.
9. The disputed bonuses must be apportioned according to the contractual allocation under the 2009 Letter and the 2012 Letter: (a) for bonuses paid from 1 April 2009 up to 29 February 2012, the disputed bonuses attributable to services rendered in Macau should be adjusted to 30% of his total bonuses paid by Company H, and the remaining 70% should be subject to Hong Kong salaries tax; and (b) for bonuses paid from 1 March 2012 onwards, his disputed bonuses attributable to services rendered in Macau should be adjusted to 45% of his total bonuses paid by Company H, and the remaining 55% for the same period should be subject to Hong Kong salaries tax.
10. The apportionment should be made on the basis of the contractual apportionment during the respective vesting periods when the appellant performed his service to earn those share option: (a) in relation to the share

option gain for the 1,000,000 shares in Company D vested on 8 May 2010, the share option gain attributable to services rendered in Macau should be adjusted to 30% (instead of 45%) and the remaining 70% should be subject to Hong Kong salaries tax; (b) in relation to the share option gain for the 800,000 shares in Company D vested on 8 May 2012, the share option gain attributable to services rendered in Macau should be adjusted to 30% of the share option gain from 800,000 x 1028/1096 shares and 45% of the share option gain from 800,000 x 68/1096 shares, and the remaining share option gain of the 800,000 shares should be subject to Hong Kong salaries tax.

**Obiter:**

11. There was good reason that income derived from services rendered outside Hong Kong under section 8(1A)(c) should also include leave pay attributable to such services rendered outside Hong Kong. With this in mind, the formula in calculating the excluded income in the TITO Approach under section 8(1A)(c) should be the percentage of income represented by the aggregate of the working days outside Hong Kong and the leave days attributable to services rendered outside Hong Kong (instead of merely counting the days the taxpayer stayed outside Hong Kong), divided by calendar days.

**Appeal is allowed in part.**

Cases referred to:

Lee Hung Kwong v Commissioner of Inland Revenue [2005] 4 HKLRD 80  
Commissioner of Inland Revenue v George Andrew Goepfert [1987] 2 HKTC 210  
Kwong Mile Services Ltd v Commissioner of Inland Revenue (2004) 7 HKCFAR D43/94, IRBRD, vol 9, 278  
D106/89, IRBRD, vol 6, 391  
Varnam (Inspector of Taxes) v Deeble [1985] STC 308  
D41/09, (2009-10) IRBRD, vol 24, 780  
D28/04, IRBRD, vol 19, 226  
Platten (Inspector of Taxes) v Brown [1986] STC 514

Julian Lam, instructed by Messrs Baker & McKenzie, for the Appellant.

Paul Leung, instructed by the Department of Justice, for the Commissioner of Inland Revenue

**Decision:**

1. This appeal concerns the issues of dual employment contracts for employments in Hong Kong and another jurisdiction: whether or not, for Hong Kong Salaries Tax ('**Salaries Tax**') purpose, the employee will be considered as having two

employments (in two jurisdictions) or just one employment located in Hong Kong. And if in the circumstances the employee is considered to have only one employment located in Hong Kong, for the facts in this Appeal whether a time-in-time-out should be adopted for the purposes of Section 8(1A)(c) of the Inland Revenue Ordinance (the ‘**Ordinance**’).

2. The relevant years of assessment subject to this Appeal are 2009/10, 2010/11, 2012/13 and 2013/14<sup>1</sup> (the ‘**Relevant Years**’).

### **Factual Background**

3. The Appellant, Mr A (‘**the Appellant**’) and the Respondent, the Commissioner for Inland Revenue (the ‘**Commissioner**’) have agreed to a Statement of Agreed Facts dated 23 November 2020 (‘**Agreed Facts**’). These facts, as annexed to Annex 1 of this Decision, form the finding of facts of this Board. The Board also adopts the abbreviation in Agreed Facts to this Decision.

4. The Appellant himself and one Mr B, Position C of Human Resources and Administration of Company G and Company H, gave evidence at the hearing. The Appellant also produced a witness statement of one Mr E, Position F of the Group, but Mr E did not attend the hearing to give evidence.

5. Company D has been listed on the Main Board of the Stock Exchange of Hong Kong under stock code XX and its the ultimate holding company of the Company D Group (the ‘**Group**’). Company D is a Hong Kong incorporated company.

6. At the relevant times, the Group had two principal businesses:

- (1) Industry V and Industry X, involving the operation of games in facility W, provision of hospitality and related services in Macau; and
- (2) Construction materials involving the manufacture, sale and distribution of construction materials in Hong Kong, Macau and the Mainland.

7. Within the Group, there are two relevant services companies: Company G (incorporated in Hong Kong) and Company H (incorporated in Macau), whose specific purpose is said to be hiring staff to provide services to other members of the Group.

8. In January 2004, the Appellant was employed, on a part time basis, by Company J to advise on the corporate finance activities of the Mr K’s family group, ie the Company J. The Appellant became a full time employee in July 2004. The Appellant was an investment banker before joining the Company J. Before joining the Company J, he was the Position L of the investment banking division of Bank M. As such, he had

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<sup>1</sup> There is no dispute for the year of assessment 2011/12.

experience in capital markets, project finance, mergers and acquisition. He was a corporate finance professional and an investment banker.

9. During the Appellant's time at Company J as 'Position N', he carried a 'Company P' name card signifying his role in the chairman office of the Mr K's family. The Appellant was personally known to Mr Q, Position R of the Company J, since their high school days in Hong Kong. The Appellant's main role was to develop the newly awarded industry V concession in Macau, and in particular to restructure the Macau business and ultimately inject the Macau industry V business into the Group by way of a reverse takeover scheme.

10. In July 2005, the Company J successfully injected the Macau industry V business into Company D (then named Company S), by way of a reverse takeover scheme. The Appellant was a lead members of the transaction team who played a substantial role in structuring and implementing the reverse takeover exercise, and after group restructuring the Appellant was named Position T, Strategic Planning of Company D replacing his previous employment.

11. On 1 November 2005, the Appellant entered into an employment agreement with Company G with the title Position T, Strategic Planning (the '**2005 HK Agreement**'). His base salary was HK\$163,333 per month, with monthly allowance of HK\$45,000. The principal place of business of Company G was in Hong Kong. The Appellant testified that his main responsibility within the Group was to support and service the Hong Kong administration of Company D, and the industry V business in Macau. In particular, it was an express term of his employment agreement that the Appellant's principal place of work in Hong Kong would be designated by Company G and Company G would have the right to require the Appellant to work at other locations in or outside Hong Kong. It is undisputed that the Appellant was a senior employee within the Group.

12. The Appellant's employer, Company G, was a vehicle of the Group to engage senior executives for the purpose of serving the Group by providing corporate and administrative support<sup>2</sup>. At all relevant time, the Appellant received instructions from and reported to Group Position R, Mr Q, in running the Strategic Planning Department and supervising the Legal Department from the offices in Hong Kong and Macau.

13. From 2005 to 2009, the Appellant continued to play an important role in the Group's corporate finance activities as Position T of strategic planning. For instance:

- (1) In December 2005, the Group raised US\$850 million through the issue of bonds for the construction and expansion of two Macau hotels;
- (2) During 2006-2007, the Appellant helped raise capital for the Group; and

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<sup>2</sup> According to Mr B, Company G had around 90 employees during the Relevant Years.

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- (3) In 2009, the Appellant handled 3 milestone transactions relating to the Macau business of the Group.

14. As the Group's main business focus onwards had been in Macau as the industry V business grew, the Appellant from 2005 onwards also had been travelling to Macau to provide his service.

15. In early 2009, the Group became concerned as to whether such employees were contravening Macau labour/ immigration law, specifically, the requirements by law that: (a) non-residents must obtain a work permit called a 'Blue Card' if they are to work in Macau for periods exceeding 45 days during a 6 month period; and (b) a non-Macau resident may only obtain a Blue Card if he/ she is working for a Macau resident (or non-resident with an establishment in Macau) in Macau. As the Group progressively developed its business into Macau and that the senior employees increasingly travelled there to render their services, in order to ensure compliance with the Macau legal requirement, the Group decided that some of the senior employees would also be employed by Company H, so that they could apply for the Blue Card and work lawfully in Macau.

16. Against these background, the Appellant entered into what he categorised as a 'dual employment' with Company G and Company H in April 2009 onwards as detailed below. Insofar as the function of Company H is concerned, according to the Appellant and Mr B:

- (1) Company H was incorporated and with place of business in Macau. It was a subsidiary of the Group with the provision of management, human resources and consultation services as its principal activities. It was first set up to handle the human resource matters in February 2006;
- (2) During the Relevant Years, Company H had around 1,400 employees. Around 8 to 10 of them (who were employees holding senior management roles within the Group who were required to travel to Macau for work in respect of the Macau-based industry V business) also had an employment agreement with another Hong Kong entity of the Group.

17. On 1 April 2009, the Appellant entered into another employment arrangement with the Group. By a letter dated 1 April 2009 (the '**2009 Letter**'), Company G and the Appellant agreed that the Appellant's employment terms and conditions with Company G would be revised, and that the secondment with Company H would take effect from 1 April 2009. Further to the 2009 Letter, on the same date, the Appellant entered into employment agreements with the Group, namely the 2009 HK Agreement with Company G and the 2009 Macau Agreement with Company H, as Position T, Strategic Planning.

18. The 2009 Letter was addressed to the Appellant and signed for on and on behalf of Company G and provides as follows:



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‘Re:                      *Secondment to [Company H]*

*Further to our discussion regarding your secondment to [Company H] in Macau, it is agreed that your employment terms and conditions with [Company G] will be revised as follows:-*

- 1. This secondment will take effect from April 1, 2009 until such time as mutually agreed between you and [Company G].*
- 2. During this secondment, you are expected to commit approximately 30% of your time and effort to [Company H], with the remaining dedicated to [Company G]. Such time allocation will be subject to change to reflect the business needs.*
- 3. [Company H] will pay you a monthly basic salary of MOP86,520 during the secondment. Such amount will be deducted from your total remuneration under your employment agreement with [Company G].*
- 4. Your entitlement to other benefits in your employment agreement with [Company G] including but not limited to bonuses, share option scheme, annual leave, medical insurance benefit, retirement scheme etc. will be appropriately reduced or will cease to the extent the same benefit is provided by [Company H].*
- 5. In the event of any discrepancies between the terms of your employment contract with [Company G] and that set out in this letter, the terms in this letter shall prevail.’*

19.                      The material terms of the 2009 HK Agreement and 2009 Macau Agreement are set out at paragraph 5 and 6 of the Agreed Facts. In essence:

- (1) The Appellant’s title remained unchanged. The Appellant was named as Position T, Strategic Planning under both the 2009 HK Agreement and 2009 Macau Agreement;
- (2) Under the 2009 HK Agreement, the Appellant’s actual scope of work and responsibility should be determined by Company G from time to time. Company G could relocate or reposition the Appellant to other departments or posts within Company G or the Group. The Appellant’s principal place of work in Hong Kong would be designated by Company G and Company G would have the right to require the Appellant to work at other locations in or outside Hong Kong. The Appellant’s base salary would be HK\$235,000 per month with housing allowance of HK\$45,000 per month, payable to the Appellant’s bank account in Hong Kong;

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- (3) Under the 2009 Macau Agreement, the Appellant was to perform duties in relation to the business of Company H or any associated company assigned to him by Company H. The Appellant's salary was stated to be MOP86,520 per month, to be paid to the Appellant's bank account in Macau. It was also an express term that the Appellant should not undertake any other business or profession or become an employee of other company;
- (4) Under both the 2009 HK Agreement and the 2009 Macau Agreement, the Appellant would be entitled to participate in executive bonus plan and granted executive share option as determined by Company G and Company H respectively; and
- (5) The 2009 HK Agreement was governed by Hong Kong laws whilst the 2009 Macau Agreement was governed by Macau laws.

20. Reading the 2009 Letter in conjunction with the 2009 HK Agreement and the 2009 Macau Agreement, the Appellant's base salary payable under the 2009 HK Agreement would be deducted by the base salary paid by Company H, so that Company H would be paying monthly salary to the Appellant in approximately 30% of the total salary and housing allowance payable to the Appellant under both agreements, reflecting the contractual apportionment of the Appellant's time serving Company H. Likewise, any of the Appellant's bonus and share option entitlement under the 2009 HK Agreement would be deducted by the same amount paid/ granted by Company H to the Appellant.

21. At the material time, Company G shared the same Hong Kong address with Company D at Location U, Hong Kong.

22. After the entering of the 2009 HK Agreement and the 2009 Macau Agreement, according to the Appellant's evidence:

- (1) Company H proceeded to apply for and obtain the relevant approvals for the Appellant's employment from the Macau Labour Affairs Bureau which imposed certain conditions in relation to compliance of Macau labour law;
- (2) Company G and Company H each bore their respective cost of the salaries, allowances and bonuses paid. Company H was not being reimbursed by Company G for the remuneration paid by Company H under the 2009 Macau Agreement; and
- (3) Company H deducted their Macau salaries tax at source and paid it directly to Macau Financial Services Bureau.

23. In 2012, the Appellant's employment arrangement with the Group was further adjusted for the reason that, as explained by the Appellant, there was an increase in demand for the Appellant's services for the Macau business operations. By a letter dated

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22 March 2012 (the ‘**2012 Letter**’), Company G informed the Appellant that effective from 1 March 2012, the Appellant would commit approximately 45% of his time and effort to Company H in Macau for his secondment with Company H, with the remaining dedicated to Company G. The Appellant’s based salary was also changed: Company G would pay the Appellant a monthly salary of HK\$119,780 and a monthly housing allowance of HK\$45,000 in Hong Kong whereas Company H would pay the Appellant a monthly basis salary of MOP138,865 (equivalent to HK\$134,820) in Macau. The terms of the 2009 HK Agreement and 2009 Macau Agreement otherwise remained unchanged. On this basis, the Appellant’s based salary payable by Company H would be about 45% of his total based salary and housing allowance payable by Company G and Company H.

24. In the Relevant Years subject to this appeal, the Appellant earned the following income (from both Company G and Company H):

	<b><u>2009/10</u></b>	<b><u>2010/11</u></b>	<b><u>2012/13</u></b>	<b><u>2013/14</u></b>
<b>Salary</b>	HK\$2,820,000	HK\$2,820,000	HK\$3,244,020	HK\$3,841,740
<b>Bonus</b>	HK\$588,000	HK\$873,768	HK\$1,791,407	HK\$2,045,861
<b>Housing Allowance</b>	HK\$540,000	HK\$540,000	HK\$540,000	HK\$540,000
<b>Share option gain</b>				HK\$88,062,000
<b><u>Total Income</u></b>	<b><u>HK\$3,948,000</u></b>	<b><u>HK\$4,233,768</u></b>	<b><u>HK\$5,575,427</u></b>	<b><u>HK\$94,489,601</u></b>

25. Of the Appellant’s total income, the following was paid by Company H:

	<b><u>2009/10</u></b>	<b><u>2010/11</u></b>	<b><u>2012/13</u></b>	<b><u>2013/14</u></b>
<b>Salary</b>	HK\$1,008,000	HK\$1,008,000	HK\$1,702,800	HK\$1,971,780
<b>Bonus</b>	HK\$588,000	HK\$873,768	HK\$1,791,407	HK\$2,045,861
<b>Share option gain</b>				HK\$39,627,900
<b><u>Total Income Paid by Company H:</u></b>	<b><u>HK\$1,596,000</u></b>	<b><u>HK\$1,881,768</u></b>	<b><u>HK\$3,494,207</u></b>	<b><u>HK\$43,645,541</u></b>

### The Disputed Sums

26. These incomes paid by Company H are all subject to dispute in this Appeal, and are referred as the ‘**Disputed Salary**’, the ‘**Disputed Bonuses**’ and the ‘**Disputed Share Option Gain**’ respectively (collectively the ‘**Disputed Sums**’).

27. In relation to the Disputed Bonuses:

- (1) At the relevant times the Group maintained an Executive Bonus Plan (‘**EBP**’) to award employees based on performance;

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- (2) For 2009, the EBP was calculated by reference to corporate performance only. According to the EBP Handwork of the Group, the corporate performance was defined by reference to the financial and non-financial performance of the Group's industry V business. From 2010 onwards, individual performance with weight of 30% was also taken into account for the purpose of calculating the final multiplier for the bonus; and
- (3) All the bonuses during the Relevant Years were issued by the Group and paid by Company H. It was explained to the Commissioner that it was Company H which paid the Appellant was because of the Appellant's contributions to the Macau business.

28. In relation to the Disputed Share Option Gain:

- (1) It was offered to the Appellant by a letter from Company D dated 8 May 2009 ('the **Option Grant Letter**'), which offered the Appellant a total of 4.3 million shares in Company D at the option price of HK\$2.16 per share;
- (2) The vesting and option periods were:

<b><u>Vesting Periods</u></b>	<b><u>Option Periods</u></b>	Number of Shares
8 May 2009 to 8 May 2010	From 8 May 2010 to 7 May 2015	1,433,333
8 May 2009 to 8 May 2011	From 8 May 2011 to 7 May 2015	1,433,333
8 May 2009 to 8 May 2012	From 8 May 2012 to 7 May 2015	1,433,334

- (3) After the vesting of the relevant portion of the share options, the Appellant could exercise the share option at any time during the applicable option period;
- (4) The Appellant exercised his share option on 7 September 2013 and 1 February 2014 for a total of 1,800,000 shares, making a total share option gain in the sum of HK\$88,062,000. The Group attributed the share option gain between Company G and Company H, such that Company G paid 55% and Company H paid 45%. Company H deducted and paid Macau tax for the 45%; and
- (5) The 45% of the share option gain attributed by the Group to Company H is the Disputed Share Option Gain.

29. For the years of assessment from 2009 to 2014, and applying the Commissioner's counting based on the Appellant's immigration record which is undisputed by the Appellant, the number of days which the Appellant stayed in Macau are as follows:

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<u>Year of Assessment</u>	<u>Number of days in Macau</u>	<u>% of days in Macau ÷ calendar days</u>
2009/10	107.5	29.5%
2010/11	89	24.4%
2011/12	114	31.2%
2012/13	91	24.9%
2013/14	107	29.3%

**The Commissioner's Determination and Grounds of Appeal**

30. In considering the source of income of the Appellant received from Company H, the Commissioner determined that, in relation to the years of assessment 2009/10, 2010/11, 2012/13 and 2013/14<sup>3</sup>:

- (1) the Appellant's entire income (including the Disputed Sums) was derived from his employment with Company G and should be chargeable to Salaries Tax, subject to exemption under Section 8(1A)(c) of the Ordinance<sup>4</sup> and rejected the Appellant's claim that by having entered into the 2019 Macau Agreement he held a separate and distinct employment with Company H; and
- (2) In computing the amount of the Appellant's income attributable to his service rendered in Macau for the purpose of the exemption under Section 8(1A)(c) of the Ordinance, the Commissioner adopted the time-in-time-out approach and considered that counting the number of days the Appellant stayed in Macau by reference to the movement records obtained from the Immigration Department is a fair and reasonable basis ('**TITO Approach**') of excluding such part of the Appellant's income from assessment of Salaries Tax.

31. In this appeal, the Appellant raised the following grounds:

- (1) The Appellant had a bona fide employment contract with Company H, a contract which was governed by Macau law and enforceable in the courts of Macau, to comply with Macau labour/ immigration law and the Appellant was legally engaged and remunerated by Company H. As such, the Commissioner erred by treating the 2009 Macau Agreement as having no significance and wrongly concluded that the Appellant only had one employment and attributed all of the Appellant's income to his Hong Kong employment ('**Ground 1**'); and
- (2) Alternatively, should this Board find there was only one employment in Hong Kong, the TITO Approach should not be applied for the

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<sup>3</sup> There is no dispute for the year of assessment 2011/12.

<sup>4</sup> As the Appellant had rendered services in Hong Kong and he was present in Hong Kong for more than 60 days, exemption under section 8(1A)(b)(ii) of the Ordinance is inapplicable.

purpose of exemption under Section 8(1A)(c) of the Ordinance  
(‘Ground 2’).

**Applicable laws and legal principles**

32. Section 8(1) of the Ordinance provides:

*‘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;’*

33. For the purpose of ‘income arising in or derived from Hong Kong from any employment’, Section 8(1A)(a) of the Ordinance provides:

*‘(a) includes... all income derived from services rendered in Hong Kong including leave pay attributable to such services...’*

34. Relevant to this Appeal, sections 8(1A)(c) of the Ordinance excludes certain income from the charge to salaries tax:

*‘(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.’*

35. ‘Income from any office or employment’ is defined in Section 9(1) of the Ordinance to include:

*‘(a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others...*

*(d) any gain realized by the exercise of, or by the assignment or release of, a right to acquire shares or stock in a corporation obtained by a person as the holder of an office in or an employee of that or any other corporation.’*

36. In Lee Hung Kwong v. Commissioner of Inland Revenue [2005] 4 HKLRD 80, the test for determination of the source of income under Section 8 of the Ordinance has been set out by To J as follows, after adopting the approach in Commissioner of Inland Revenue v George Andrew Goepfert [1987] 2 HKTC 210:

*‘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 statute 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.’*



37. In determining the source of income, the Commissioner is entitled to scrutinise all evidence relevant to the matter and is not bound to accept as conclusive any claim made by the employee. In Goepfert, Macdougall J said (at 237):

*‘This does not mean that the Commissioner may not look behind the appearances to discover the reality. The Commissioner is not bound to accept as conclusive, any claim made by an employee in this connection. He is entitled to scrutinise all evidence, documentary or otherwise, that is relevant to this matter.’*

38. In relation to the concept of ‘secondment’, To J said the following in Lee Hung Kwong (at paragraph 62):

*‘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.’*

### **The Appellant’s arguments on source of income of his employment – Ground 1**

39. In this appeal, the Appellant raised the following primary arguments:

- (1) The whole contractual regime in entering the 2009 Letter, the 2009 HK Agreement, the 2009 Macau Agreement and the 2012 Letter was a genuine commercial transaction that cannot be ignored. The Appellant also relies on Kwong Mile Services Ltd v. Commissioner of Inland Revenue (2004) 7 HKCFAR and contends that unless the arrangements are sham, this Board is not to treat contracts, agreements and other acts, matters and things existing in the law as having no significance;
- (2) The legal effect of the contractual regime was to:
  - a. Split the work that the Appellant did for the Group based on the geographical location, based on common sense analysis of the way Company G and Company H operated and the purpose of

the 2009 Macau Agreement to ensure that the work the Appellant did in Macau was legal;

- b. Attribute the income that the Appellant earned according to the same geographical split;
- (3) Taking all the circumstances into account, the 2009 Macau Agreement created a new employment with a new employer. To conclude otherwise would be to ignore the legal documents and the real legal employment relationship that was created and conclude that the Group and the Appellant was misleading the Macau authorities.

40. In arguing that the whole contractual regime was a genuine commercial transaction, the Appellant raised the following points:

- (1) The 2009 Letter, the 2009 HK Agreement and the 2009 Macau Agreement should be regarded as a part of a single transaction which was subsequently varied by the 2012 Letter. The evidence shows that these documents were entered into on the same day (1 April 2009) for compliance purpose with Macau laws and were respectively signed by senior personnel of the Group (Mr Q and Mr B) whose knowledge would be mutually imputable to subsidiaries of the Group.
- (2) The background of the contractual regime was put in place for real commercial reasons, namely to comply with Macau labour/immigration laws:
  - a. Even though the Appellant's role as Position T, Strategic Planning did not change, since 2005 the Macau business grew substantially over time and that necessitated the Appellant to spend more time in Macau;
  - b. According to Mr B, the Macau law only applied when non-Macau resident works in Macau for periods exceeding 45 days during each six-month period. The more time the Appellant spent in Macau, the more risky it was from a compliance perspective, and therefore it was necessary for Company H to employ the Appellant to comply with Macau law;
  - c. The Appellant gave evidence to the effect that as tax in Macau was on a withholding basis, there was a need to estimate the amount of time he had to spend outside Hong Kong to perform his Macau duties. The Appellant's evidence was that the 30% estimation was based on his workload and schedule at the time, such estimation was subsequently increased to 45% (which included time spent outside of Hong Kong) in the 2012 Letter after review of his job duties;

- d. Therefore, the Appellant argued that the 2009 Macau Agreement and the split of time spent is not artificial or a sham.

41. In relation to the legal effect of the contractual regime, the Appellant further made the following points:

- (1) Company G and Company H had no particular function other than to recruit employee.
- (2) In fact, their areas of support service did overlap. In relation to Company G, it handled human resources matters of Hong Kong based employees who rendered support services to other entities in the Group. In relation to Company H, it handled human resources matters of employees who were required to be in Macau from time to time when providing professional services to support the business operations of the Group entities in Macau;
- (3) Therefore, the distinction between the work done by Company G staff, on the one hand, and the work done by Company H staff, on the other hand, is purely geographical. The Appellant argued that the common sense approach should give effect to how the Group approached the employment of staff by Company G and Company H;
- (4) Given these analysis, the contractual regime attributed the Appellant's income according to the split, based on the Appellant's best estimate of the work he would do in either location – the income that the Appellant earned from Company H was attributed to his work outside Hong Kong, whilst the income the Appellant earned from Company G was attributed to his work in Hong Kong; and
- (5) Accordingly, the Appellant submitted that the 2009 Macau Agreement created a new employment with Company H and his income from Company H should not be included in his Hong Kong salaries tax assessments.

#### **Analysis on source of income of the Appellant's employment – Ground 1**

42. Applying Lee Hung Kwong, the questions which this Board asks are:

- (1) whether the income which is sought to be charged is income from a Hong Kong source and if so, the place where the services are rendered is irrelevant. If the income is from a Hong Kong source, it is subject to the charge regardless of whether the services are rendered in or outside Hong Kong (paragraph 23); and
- (2) in ascertaining the source of income, the question is where the income

really comes to the employee (paragraph 26). The Board will have to determine the locality which the employee earned his payment and not the place where the activities of the employee are exercised. 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 conclusive (paragraph 24). The ‘totality’ of all the factors will have to be considered (paragraph 26).

43. Although regard must first be to the contract of employment including 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, none of these factors are determinative (Paragraph 26 of Lee Hung Kwong).

44. An example of how the Board approaches the question of the source of income can be seen in D43/94, where the Board held that (at paragraph 5):

*‘... First of all, one must bear in mind the difference between the employment and the services rendered under the employment contract. An employment is a state in which an employee is employed by an employer; it is the source of the employee’s income, but it is not necessarily located where the employee renders his service under the employment contract. For example, a person who is employed by a Hong Kong company and is paid by the Hong Kong company from money originating in Hong Kong to perform services elsewhere is liable to salaries tax, because the source of the income, the employment, is located in Hong Kong (... CIR v Goepfert 2 HKTC 210 at 231-232 and 237). Furthermore, the same employment may continue notwithstanding the variation of the terms and conditions of the employment contract or even the replacement of the entire contract by a new employment contract (see D101/89, IRBRD, vol 6, 375), and notwithstanding that the employee is seconded or transferred to work outside Hong Kong (see D37/88, IRBRD, vol 3, 360 and D67/89, IRBRD, vol 5, 52).’*

45. It is clear that from the events leading up to the Appellant’s employment with Company G in November 2005, the Appellant joined Company G as its Position T, Strategic Planning, as a senior executive to serve the Group which was expanding its industry V and industry X business in Macau. In particular, the Appellant offered his service and experience to the Group in corporate finance, investment banking, capital markets and strategic planning.

46. Although the Group’s expanding business was in Macau, the Group was part of the listed entity Company D which was incorporated in Hong Kong with registered office in Location U, Hong Kong. The business of Company G was to be responsible for managing the functions of company secretary, investor relations, corporate finance, legal and strategic planning.

47. It is not in dispute that prior to the entering of the 1 April 2009 contracts,

the Appellant was at all relevant times employed by Company G after 2005 and that his entire income would be subject to Hong Kong salaries tax, notwithstanding he was required to and had from time to time travelled to Macau to meet business needs. In the Appellant's evidence, the Appellant had during 2005 to 2009 handled corporate finance activities for the purpose of developing the Group's Macau business, the Appellant has not disputed that the source of income of these services was coming from Hong Kong.

48. Despite the entering of the 1 April 2009 contracts, it did not create a fundamental change to the job duties of the Appellant in the Group:

- (1) In the letter from Company G to the Revenue dated 20 May 2011, Company G confirmed that there was no fundamental change in the nature of the Appellant's work in relation to his secondment in Macau. It was said that the secondment provided '*much improvement on the efficiency because with the contract, [the Appellant] can apply for a working permit in Macau which he can officially work there*';
- (2) In oral evidence, the Appellant confirmed that he did not receive any increase in overall salary in April 2009 when the 'secondment' arrangement was made;
- (3) The Appellant also suggested that had it not been the requirement under the laws of Macau to have a contract and work permit, the Appellant would not have had to sign the 2009 Macau Agreement with Company H;
- (4) The Appellant's salary slip shows that (a) he was considered to be in Company G's Strategic Planning Department and (b) in Company H he was considered to be a Position T, Strategic Planning in its 'special project' department. The organisation chart as produced by Company G shows that the Strategic Planning Department was in Hong Kong. There is no such organisation chart suggesting there was an equivalent department in Macau; and
- (5) In responding to the Revenue's request concerning the Relevant Years, Company G described Company H to be a provider of professional services to support the Macau business operations, including operating industry V, hotels, food and beverages and retail operations. The Appellant's job duties seem to dovetail with the functions provided by the employees of Company G rather than Company H during the Relevant Years.

49. In considering the locality which the Appellant earned his payment before and after the signing of the 1 April 2009 contracts, the following facts are relevant:

- (1) As discussed above, despite the entering of the 1 April 2009 contracts,

there has not been a fundamental change to the job duties of the Appellant in the Group;

- (2) Under both the 2005 HK Agreement and the 2009 HK Agreement, it is clear that the Appellant could be legitimately repositioned to Macau, on a secondment basis, part-time or full-time, in accordance with the need of Company G;
- (3) The secondment was in fact initiated, supervised and controlled by Company G, evidenced by the signing of the 2009 Letter and 2012 Letter, which suggests that the secondment of the Appellant to Company H was part and partial of the Appellant's job duties as a senior executive employed by Company G;
- (4) The total of the Appellant's salary was set out under the 2009 HK Agreement, and apportioned through the 2009 Macau Agreement reading in conjunction with the 2009 Letter;
- (5) The estimate of time to be spent by the Appellant in Macau was also dictated by Company G under the 2009 Letter and 2012 Letter; and
- (6) In fact, in the Employers' Returns filed by Company G for all the Relevant Years, Company G declared the full amount paid by Company G and Company H as the remuneration of its employee.

50. Having considered the test in Lee Hung Kwong, the question which the Board asks itself is whether the income sought to be charged is from a Hong Kong source and if so, the place where the services are rendered is irrelevant. In this regard, if the Board finds that the source of the Appellant's income was from a Hong Kong source, it is irrelevant that some of the services rendered by the Appellant was in Macau. The Appellant's argument that his income earned from Company H was attributed to his work outside Hong Kong therefore cannot stand if the income came from a Hong Kong source.

51. In determining the source of the Appellant's income, the 'totality' of the facts will have to be considered. As the Appellant's source of income prior to the 1 April 2009 contracts was undisputedly coming from a Hong Kong source, the question to ask is has there been any change in substance of the Appellant's job functions and therefore his source of income after 1 April 2009. Having found that there was no fundamental change in substance of the Appellant's job functions despite entering the 1 April 2009 contracts, the Board considers that there was also no change in the Appellant's source of income, which was at all material times in Hong Kong before and during the Relevant Years. In particular, the Board also considers that:

- (1) After the entering of the 1 April 2009 contracts, the Appellant's job duties as Position T, Strategic Planning continued to be performed with Company G with headquarters in Hong Kong. The Appellant has not produced evidence to prove there was an equivalent

department in Macau;

- (2) Ultimately, the central management of the Group was in Hong Kong. The ultimate holding company, Company D, was incorporated in Hong Kong and listed in Hong Kong. The Appellant was part of the Group's senior management team responsible in running the strategic planning department and supervising the Legal Department, reporting to Mr Q, Position R of the Group and part of the central management of the Group in Hong Kong;
- (3) As admitted by the Appellant, the 2009 Macau Agreement was entered for the purpose of compliance of Macau laws. It is not the Appellant's case that the 2009 Macau Agreement was entered due to a fundamental change of the Appellant's job functions and duties. In fact, Company G confirmed that there was no fundamental change in the nature of the Appellant's work;
- (4) In fact, during the Relevant Years, the Appellant still spent substantial amount of his time in Hong Kong; and
- (5) The whole of the 1 April 2009 contracts and the 2012 Letter were arranged, supervised and directed by Company G. The 2009 Macau Agreement was dependant on the existence 2009 HK Agreement as the Appellant was 'seconded' to Macau from Company G. There was no suggestion that the 2009 Macau Agreement could be independent from the existence of the Appellant's employment with the Group through Company G.

52. Notwithstanding the place of payment under the 2009 Macau Agreement was in Macau, this factor is not determinative and is only one of the factors in considering the totality of all the factors. For instance, 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 (paragraph 24 of Lee Hung Kwong). Likewise, it must also be true that if the totality of the factors indicates that the source of income under the 2009 Macau Agreement is in Hong Kong, the place of payment in Macau is clearly a non-determinative factor.

53. As stated in paragraph 62 of Lee Hung Kwong, a secondment does not necessarily change the location of employment as it depends on ultimately where the income comes to the employee, ie the source of income. The test was followed in D43/94 where the Board held that the same employment may continue notwithstanding the variation of the terms and conditions of the employment contract or even the replacement of the entire contract by a new employment contract, and notwithstanding that the employee is seconded or transferred to work outside Hong Kong. Ultimately the test is where is the source of income.

54. Nor is it necessary for the Board to make a finding that contractual regime

was a sham:

- (1) The test is, again, the locality which the employee earned his payment, and not the place where the activities of the employee were exercised. The Appellant could, under the 2009 Macau Agreement, legitimately render his services in Macau but it does not mean that the locality of his earning was necessarily coming from Macau;
- (2) According to Goepfert, the Commissioner is not bound to accept as conclusive any claim made by an employee and the Commissioner is entitled to scrutinise all evidence relevant to the matter. This is in line with the ‘totality’ test which the Board is entitled to consider all the factors concerning the locality of earning; and
- (3) The example given in Paragraph 62 of Lee Hung Kwong is an illustration that the Board does not need to find that the secondment was a sham before considering that the secondment does not change the location of employment.

### **Conclusion on Ground 1 – source of income of the Appellant’s employment**

55. For all these reasons above, the Board finds that at all material times and during the Relevant Years, the Appellant only had one employment (ie Hong Kong employment) for purposes of assessment of Salaries Tax under section 8(1) of the Ordinance. Alternatively, Section 68(4) of the Ordinance provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Appellant, the Board also considers that the Appellant has not been successful in discharge his onus of proving that the Commissioner’s determination that his entire income was derived from his employment with Company G was wrong.

56. The findings above apply to all income paid by Company H during the Relevant Years, ie the Disputed Salary, Disputed Bonuses and the Disputed Share Option Gain.

### **The Appellant’s arguments on apportionment under Section 8(1A)(c) of the Ordinance – Ground 2**

57. Having found that there was only one employment in Hong Kong for the purposes of assessment of Salaries Tax under section 8(1) of the Ordinance, the next issue is whether the TITO Approach should be applied for the purpose of exemption under Section 8(1A)(c) of the Ordinance.

58. The Appellant argued that:

- (1) Where determining whether any part of income derived under a foreign employment is attributable to services rendered in or outside Hong Kong for the purposes of section 8(1A)(a) and (c), the



Ordinance does not contain any provisions to regulate the manner in which such determination should be made. The Appellant submits that the ultimate question is always whether the income was derived from services rendered in or outside Hong Kong;

- (2) The TITO Approach is based on an evidential assumption – it assumes that on each day of the year, the taxpayer renders services from which he earns  $1/365^{\text{th}}$  of his/her annual income. Where the evidence shows that the TITO Approach is not applicable, it should not be adopted, citing D106/89 6 IRBRD 391 in support where Henry Litton QC who chaired the Board explained:

*‘In reality, the “time-in time-out” formula of apportionment is a rough and ready method used to assess the income chargeable under section 8(1A)(a) when the derivative of the income with reference to the services rendered cannot be identified. The application of the formula is not set in concrete, and is liable to be displaced by the facts. When the derivation of an item of income is clearly identifiable (and this can go both ways) there is no room for the application of the formula.’*

- (3) Thus, if the derivation of an item of income is provided for in the contract of employment, which for example specifically allocates part of the remuneration to the overseas duties, then that should be adopted instead of a simple time apportionment basis. The Appellant cited English Court of Appeal decision Varnam (Inspector of Taxes) v Deeble [1985] STC 308 in support of this proposition.

59. Applying these principles, the Appellant further submitted that:

- (1) In relation to the Disputed Salary, it was a specified sum under the 2009 Macau Agreement (as varied by the 2012 Letter) which also mirrored the Appellant’s work split between Company G and Company H. Thus the Disputed Salary that the Appellant received from Company H was attributable to work the Appellant did outside Hong Kong.
- (2) In relation to the Disputed Bonuses, these were issued to the Appellant by Company H which means that they must have come from the employment with Company H, and the Appellant stressed that Company H would not award the Appellant for work he did under the employment with Company G. As such, by applying the principle in Varnam v. Deeble, the Disputed Bonuses were attributable to work that the Appellant did outside Hong Kong.
- (3) In relation to the Disputed Share Option Gain:

- a. The Share Option Gain came from the Group because of his continued service for the Group, not because of his work for Company G or Company H;
  - b. The Share Option Gain was apportioned by the Group by attributing 55% to the Appellant's Hong Kong services and 45% to the Appellant's Macau services (ie the Disputed Share Option Gain);
  - c. As such, by applying the principle in Varnam v. Deeble, the Disputed Share Option Gain was attributable to work that the Appellant did outside Hong Kong.
- (4) In relation to the Disputed Salary, the Disputed Bonus and the Disputed Share Option Gain, income tax has been paid in Macau.

**The Commissioner's arguments on apportionment under Section 8(1A)(c) of the Ordinance – Ground 2**

60. In response, the Commissioner made the following submissions:

- (1) The TITO Approach is one tried and tested method relied upon in a number of previous Board decisions, citing D41/09 and D28/04 in support. In the absence of any reliable evidence to the contrary, a taxpayer's salary would accrue from day to day;
- (2) The operative words in the statutory provision are 'services rendered in [Macau]'. There is no evidential basis for taking 30% or 45% figures as the Appellant's services rendered in Macau, which were only the Appellant's forward-looking 'guestimates' of the time he spent in Macau when the 2009 Letter and 2012 Letter were issued;
- (3) The movement records of the Appellant show that the 30% and 45% figures do not reflect the actual situation. For example, in 2012/13 and 2013/14, the Appellant spent 91 and 107 days in Macau representing 24.9% and 29.3% of the year;
- (4) An example would be if the contracts state the splitting of the salaries to be in the ratio of 90:10 for Macau: Hong Kong, whereas in reality the taxpayer only rendered his services in Macau for 20% of his time each year as shown in his movement records, it cannot be right that it forms the basis for exemption to the tune of 90%; and
- (5) Therefore, the Appellant has failed to discharge the burden to prove that the TITO Approach was wrong.

**Analysis on apportionment under Section 8(1A)(c) of the Ordinance – Ground 2**

61. In Varnam v. Deeble, an English Court of Appeal decision, Lord Justice Browne-Wilkinson said:

*‘The words “attributable to duties performed outside the United Kingdom” do not in my judgment necessarily point to the attribution being made by reference to the nature of the duties, rather that to the time taken up in their performance. In my judgment, those words in isolation are capable of bearing either interpretation. However, 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 paragraph 2(1) that part will be the emoluments attributable to such duties, subject to the ceiling provisions of paragraph 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.’*

62. Varnam was also considered in a subsequent case Platten (Inspector of Taxes) v. Brown [1986] STC 514 where Hoffmann J (as he then was) quoted the above passage of Lord Browne-Wilkinson in Varnam and said (at 519):

*‘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.’, and then added (at 520) ‘That sentence, as it seems to me, encapsulates the ratio decidendi of the case. It requires one to ask, first, how as a matter of contract the emoluments are apportioned. If there is no specific apportionment to overseas duties, the apportionment must be made on a time basis. The effect of the Apportionment Act 1870 is that the attribution must be made in units of salary for one day.’*

63. In Varnam, a different fiscal legislative provision was considered, the question faced by the English Court of Appeal in Varnam was similar to the question under section 8(1A)(c) of the Ordinance in that both provisions are silent as to what method or test is to be applied, but it is clear that both provisions require an apportionment on some basis. It cannot be disputed that the time apportionment approach has been consistently applied in Hong Kong to determine the extent of the taxpayer’s service rendered by him in any territory outside Hong Kong, in the absence of contractual allocation. Likewise, in the absence of other indications, the basis can be made first by reference to the taxpayer’s contractual right to emoluments for the work performed, following Varnam.

64. In our view, the Appellant's contractual arrangements after 1 April 2009 not only provided for regulation of the amount of time the Appellant had to devote to the employment in Macau, they also provided for attribution of remuneration to the Appellant's Macau duties:

- (1) In the 2009 Letter, it was stated that the Appellant was expected to commit approximately 30% of his time and effort to Company H, with the remaining dedicated to Company G in Hong Kong, with a proviso that such time allocation will be subject to change to reflect the business needs;
- (2) The Appellant's total remuneration under the 2009 HK Agreement shall be deducted by the monthly basis salary of MOP86,520 under the 2009 Macau Agreement (as per the 2009 Letter). Accordingly, the salary of MOP86,520 (under the 2009 Macau Agreement) represented about 30% of the Appellant's HK\$235,000 monthly salary and HK\$45,000 monthly housing allowance under the 2009 HK Agreement;
- (3) In the 2012 Letter, it was stated that, effective 1 March 2012, the Appellant will commit approximately 45% of his time and effort to Company H in Macau for his secondment, with the remaining dedicated to Company G in Hong Kong; and
- (4) Also under the 2012 Letter, a monthly salary of HK\$134,820 (out of the aggregate of monthly salary and housing allowance of HK\$299,600) was specifically allocated for the payment from Company H, which constituted also 45% of his total monthly salary and housing allowance.

65. Whilst it is true that the 30% and 45% allocation of time could be a 'guestimate' at the time when the 2009 Letter and 2012 Letter were issued, the apportionment of salary between the Appellant's service in Macau and Hong Kong was a fixed one mirroring the estimation of time the Appellant would be required to perform his duties in Macau. After all, the test is whether the contract itself provides for how the emoluments are apportioned, and if so and in the absence of other indications, the apportionment can first be made on this basis.

66. The next question is whether the movement records of the Appellant showing that the Appellants only stayed in Macau for about 24% to 31% of the days in a calendar year during the Relevant Period a sufficient indication that the contractual allocation was not an appropriate one in this case.

67. Although the Appellant's movement records showing his stay in Macau does not differentiate which days are working days or leave days, the Commissioner accepted, in the exercise of counting days in the TITO Approach, the days the Appellant stayed in Macau represent the apportionment of his services rendered in Macau. In fact,

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from the movement records, the vast majority of the Appellant's stay in Macau falls on weekdays.

68. Under the 2009 HK Agreement and 2009 Macau Agreement, the Appellant was required to work not less than 8 hours per day on every Monday to Friday and 4 hours on alternate Saturday. In addition, the Appellant shall be entitled to public holidays in Hong Kong and Macau respectively as well as 21 working days' annual leave. Based on the Appellant's employment contracts, the Appellant had to work for about 5.25 working days a week, or about 273 days in a 52-week year, reduced to about 232 days after taking into account his annual leave entitlement (21 days a year) and public holidays (approximately 20 days a year).

69. In both of the 2009 Letter and 2012 Letter, they refer to 30% and 45% respectively of the Appellant's 'time and effort' to be committed in Company H. In our view, it clearly refers to the Appellant's work time and effort. It cannot be right to suggest that the Group required the Appellant also stayed in Macau for 30% and 45% respectively for his time whilst he was on leave, or during his time off on Saturday/ Sunday, public holidays or annual leave, nor was there any express provision for such requirements. This is particularly so as the Group knew the Appellant was a Hong Kong resident and paid housing allowance to the Appellant through Company G.

70. Accordingly, if the number of days the Appellant stayed in Macau were to be divided by a hypothetical number of total working days in a year (instead of total calendar days in a year), say 232 days, then the Appellant would have spent in Macau about 38% to 49% of his working time, as follows:

<u>Year of Assessment</u>	<u>Number of days in Macau</u>	<u>% of days in Macau ÷ (say) 232 days</u>
2009/10	107.5	46.3%
2010/11	89	38.4%
2011/12	114	49.1%
2012/13	91	39.2%
2013/14	107	46.1%

71. Having said so, this Board is not making a finding about the exact percentage of working time the Appellant had spent in Macau. Rather, the illustration shows that if the percentage allocation in the 2009 Letter and the 2012 Letter indeed refers to working time and effort, the Appellant's actual time spent in Macau by reference to total working days in a year (instead of calendar days) should be adjusted upwards. The revised percentage as illustrated above (again it is for illustration purpose only, the Board is not making a finding on the exact percentage) shows that the Appellant could have indeed spent his time in Macau which matched (if not exceeding) closer to the 'guestimate' in the 2009 Letter and 2012 Letter.

72. In these circumstances, the fact that the Appellant had spent only about 24% to 31% of his time in terms of calendar days of a year is not a sufficient indication to displace the contractual allocation. Rather, if the percentage allocation in the 2009 Letter and the

2012 Letter indeed refers to working time and effort, the two letters should represent a genuine estimation of the Appellant's working time spent in Macau. The Board also accepts the Appellant's evidence that he had spent substantial time in Macau due to the growth of the Macau business of the Group and the increasing need for him to spend time in Macau. After all, it was the Appellant's evidence (which is accepted by the Board) that he needed to sign the 2009 Macau Agreement in order to comply with the Macau regulations for his increasing stay in Macau to perform his services.

73. In relation to the Commissioner's example as to what if the contracts state the splitting of the salaries to be in the ratio of 90:10 for Macau: Hong Kong and in fact the taxpayer only spent about 20% of his time in Macau, the Board agrees with the Counsel for the Appellant that the contractual attribution approach is subject to anti-avoidance principles and sections 61 and 61A of the Ordinance to prevent any potential abuse. Further, if the contractual attribution was not a genuine allocation by itself, it is a sufficient indication that the contractual allocation should be displaced.

74. Having considered that the apportionment should be made on the basis of contractual allocation, it is not necessary for the Board to consider whether the TITO Approach employed by the Commissioner was a correct one. For the purpose of completeness, section 8(1A)(a) of the Ordinance provides that income arising in or derived from Hong Kong includes the taxpayer's leave pay attributable to such services rendered in Hong Kong. By the same token, there is good reason that income derived by a taxpayer from services rendered by him outside Hong Kong under section 8(1A)(c) of the Ordinance should also include leave pay attributable to such services rendered outside Hong Kong. With this in mind, the formula in calculating the excluded income in the TITO Approach under section 8(1A)(c) of the Ordinance should be the percentage of the taxpayer's income represented by the aggregate of the working days outside Hong Kong and the leave days attributable to services rendered outside Hong Kong (instead of merely counting the days the taxpayer stayed outside Hong Kong), divided by calendar days.

## **Ground 2 – applying the contractual allocation to the Disputed Sums**

75. Applying the contractual allocation, the Board will proceed to consider each of the Disputed Sums.

### ***Disputed Salary***

76. In relation to the Disputed Salary (for the Relevant Years):

- (1) From 1 April 2009 up to 29 February 2012, the Appellant's salary attributable to services rendered in Macau shall be adjusted to 30% of the Appellant's total salary and housing allowance paid by Company G and Company H during the same period; and
- (2) From 1 March 2012 onwards, the Appellant's salary attributable to services rendered in Macau shall be adjusted to 45% of the Appellant's total salary and housing allowance paid by Company G

and Company H during the same period.

***Disputed Bonuses***

77. The Appellant's entitlement to Bonuses is provided in both the 2009 HK Agreement and 2009 Macau Agreement in almost identical terms. In the 2009 Letter, the Appellant's entitlement to bonuses with Company G will be appropriately reduced or will cease to the extent the same benefit is provided by Company H. Yet, throughout the Relevant Years, the Bonuses were all paid by Company H and the Appellant claims that all these bonuses were attributable to services rendered in Macau. The Appellant argued that the Disputed Bonuses were all paid by Company H because of his contributions to the Macau Business. In particular, the Appellant argued that the Executive Bonus Plan was calculated by reference to predominately the corporate performance of the Macau industry V business, and therefore the Disputed Bonuses were attributable to work that the Appellant did outside Hong Kong.

78. As the Appellant would have been entitled to Bonuses under both the 2009 HK Agreement and 2009 Macau Agreement and that the Appellant was rendering his services both in Hong Kong and Macau, it is difficult to see why the Appellant should only be paid Bonuses only from Company H as it cannot be disputed that the Appellant contributed to the Macau business when he was rendering his services in Hong Kong too. The Executive Bonus Plan also does not specify that bonuses were payable to works rendered in Macau only.

79. In the circumstances, the Disputed Bonuses must also be apportioned according to the contractual allocation under the 2009 Letter and the 2012 Letter:

- (1) For bonuses paid to the Appellant as reward of his service in relation to his employment from 1 April 2009 up to 29 February 2012, the Appellant's Disputed Bonuses attributable to services rendered in Macau shall be adjusted to 30% of the Appellant's total bonuses paid by Company H. In other words, the remaining 70% for the same period shall be subject to Hong Kong salaries tax; and
- (2) For bonuses paid to the Appellant as reward of his service in relation to his employment from 1 March 2012 onwards, the Appellant's Disputed Bonuses attributable to services rendered in Macau shall be adjusted to 45% of the Appellant's total bonuses paid by Company H. In other words, the remaining 55% for the same period shall be subject to Hong Kong salaries tax.

***Disputed Share Option Gain***

80. Likewise, the Appellant's entitlement to Share Option is provided in both the 2009 HK Agreement and 2009 Macau Agreement in almost identical terms. Under the 2009 Letter, the Appellant's entitlement to Share Option with Company G will be appropriately reduced or will cease to the extent the same benefit is provided by Company

H.

81. On 7 September 2013, the Appellant exercised the share option granted to him and subscribed 1,000,000 shares in Company D (vested to the Appellant on 8 May 2010) at the exercise price of HK\$35.55. On 1 February 2014, the Appellant further exercised the share option granted to him and subscribed 800,000 shares in Company D (vested to him on 8 May 2012) at the exercise price of HK\$70.50.

82. The Group attributed the Appellant's Share Option Gain in the financial year of 2013/14 in the proportion of 55% in Hong Kong and 45% in Macau. It was explained by Mr B:

*'In respect of employees such as [the Appellant] who is employed by both [Company G] and [Company H], his gain under the Option Scheme will be split between the two entities based on his contractual apportionment. As from 1 April 2012, he was required to devote 45% of his time in discharging his employment duties with [Company H] and 55% of his time in discharging his employment duties with [Company G]. His gain under the Option Scheme was calculated accordingly.'*

83. According to the Share Option granted to the Appellant dated 8 May 2009 by Company D, the Share Option was granted to the Appellant for the primary objective to provide the Appellant with additional incentive to contribute to the long term success of Company D. Three portions of the Share Option would vest on the Appellant depending on his years of service completed after 8 May 2009, namely one third by 8 May 2010, one third by 8 May 2011 and the remaining one third by 8 May 2012. The vested Share Option could be exercised at any time until 7 May 2015 at the exercise price of HK\$2.16 per share.

84. The Share Option was therefore granted subject to the continuous employment of the Appellant at each of the three anniversary after 8 May 2009, subject to limited exception (such as retirement, disability or cessation of employment due to the Appellant's employer ceased to be an affiliate of Company D) that the Appellant might exercise any unvested portion of the Option. Once the Share Option had been vested after the Appellant had completed the requisite period of employment, and therefore become exercisable, there is no evidence showing that the Appellant had to remain in employment as a condition for the Appellant to retain the benefit of the Share Option.

85. In other words, for the 1,000,000 shares in Company D vested to the Appellant on 8 May 2010, the Share Option had become exercisable on 8 May 2010. For the 800,000 shares of Company D vested to the Appellant on 8 May 2012, the Share Option had become exercisable on 8 May 2012. The Share Option was evidently a reward of the Appellant's past services during the different vesting periods before the Share Option had become exercisable.

86. The timing of the Appellant in exercising the Share Option after vesting is therefore the Appellant's own commercial decision which is unrelated to the Appellant's place of performance of his service at the time exercising the Share Option. Clearly, what



is more relevant is the Appellant's place of performance of his service before the Share Option had been vested to him (ie throughout the vesting periods).

87. Therefore, there is no justification of the Group to apportion the entire Share Option Gain according to the contractual apportionment at the time when the Appellant exercised the Share Option. Instead, the apportionment should be made on the basis of the contractual apportionment during the respective vesting periods when the Appellant performed his service to earn those Share Option.

88. In the circumstances, the Share Option Gain must also be apportioned during the vesting periods according to the contractual allocation under the 2009 Letter and the 2012 Letter:

- (1) In relation to the Share Option Gain for the 1,000,000 shares in Company D vested to the Appellant on 8 May 2010, the Appellant's Share Option Gain attributable to services rendered in Macau shall be adjusted to 30% (instead of 45%). In other words, the remaining 70% for the same Share Option Gain shall be subject to Hong Kong salaries tax;
- (2) In relation to the Share Option Gain for the 800,000 shares in Company D vested to the Appellant on 8 May 2012:
  - a. During the vesting period from 8 May 2009 and 8 May 2012, there were 1,096 calendar days (not including 8 May 2012);
  - b. For the 1,096 calendar days, according to the contractual apportionment, the Appellant was required to perform 30% of his time in Macau during 1,028 calendar days from 8 May 2009 to 29 February 2012;
  - c. For the remaining 68 calendar days from 1 March 2012 to 8 May 2012 (but not including 8 May 2012), according to the contractual apportionment, the Appellant was required to perform 45% of his time in Macau;
  - d. The Appellant's Share Option Gain attributable to services rendered in Macau shall be adjusted to 30% of the Share Option Gain from  $800,000 \times 1028/1096$  shares and 45% of the Share Option Gain from  $800,000 \times 68/1096$  shares. In other words, the remaining Share Option Gain of the 800,000 shares shall be subject to Hong Kong salaries tax.

## Conclusion

89. In conclusion, this Appeal is allowed in part. In a summary:

- (1) The Board rejected the Appellant's appeal on Ground 1 and affirmed that the Appellant's entire income was derived from his employment with Company G and should be chargeable to Hong Kong Salaries Tax, subject to exemption under Section 8(1A)(c) of the Ordinance; and
- (2) The Board allowed the Appellant's appeal in part on Ground 2 in that for the purpose of apportionment under Section 8(1A)(c) of the Ordinance, the contractual apportionment shall be adopted instead of the TITO Approach. The case is remitted to the Commissioner to revise the assessment based on the following rulings:
  - a. In relation to the Disputed Salaries for the Relevant Years, the Appellant's appeal is allowed and the Commissioner is directed to revise the assessment based on the ruling at paragraph 76 above;
  - b. In relation to the Disputed Bonuses for the Relevant Years, the Appellant's argument that the whole sum was attributed to Company H is rejected, and the Commissioner is directed to revise the assessment based on the ruling at paragraph 79 above; and
  - c. In relation to the Disputed Share Option Gain, the Appellant's appeal is allowed in part and the Commissioner is directed to revise the assessment based on the ruling at paragraph 88 above.