Case No. D24/17

Salaries tax – place of negotiation – locus of employment – 60 days rule – day in day out formula – sections 8(1)(a), 8(1A), 8(1B) and 68(8) of the Inland Revenue Ordinance

Panel: Cissy K S Lam (chairman), Cheung Ming Chee and Yvonne Fong.

Date of hearing: 4 August 2017.
Date of decision: 7 February 2018.

The taxpayer appealed against the Determination of the Deputy Commissioner in respect of the Salaries Tax Assessment for the year of assessment 2010/11 raised on her, arguing (1) that her employment was a non-Hong Kong employment, or alternatively (2) that her income fell within the exemption under section 8(1A)(c) of the Inland Revenue Ordinance. Company A1 headquartered in Country D had a Hong Kong subsidiary, Company E and a Mainland subsidiary, Company F. On 4 June 2010, Company E offered to employ the taxpayer as Position H and Position J after having interviewed her in Country D and on 9 June 2010 the taxpayer accepted the offer and signed a contract in Shanghai ('the HK Contract'). On 6 July 2010 the taxpayer reported to work at Branch G2 and on the same day she signed an Employment Contract dated 6 July 2010 in Chinese with Company F ('the SH Contract'). It stated in the first sentence that the taxpayer's labour relationship with Company E was terminated on 6 July 2010, and effective therefrom she was employed by Company F as Position H and Position J. On 16 December 2013 the taxpayer was asked to resign and was presented with a letter dated 16 December 2013 by which Company E accepted the taxpayer's resignation from her employment with Company E. The taxpayer pointed out that (1) she rendered her services exclusively in Shanghai, (2) her salary was paid to her by Company F at a constant rate each month and bonus was paid to her at the end of the year (the 2 sums), (3) she paid IIT monthly and produced copies of monthly IIT Payment Certificate (中華人民共和國個人所得稅完稅證明), (4) there were 7 occasions during her visits to Hong Kong when she did 'work' as opposed to purely personal pursuits. The Assessor found out from the Immigration Department that the taxpayer was in Hong Kong for 82 days during the period from 1 July 2010 to 31 March 2011 and adopted a 'day out' formula to apportion the sum for exclusion from her income.

Held:

1. The Board rejected the argument that the taxpayer's employment was a non-Hong Kong employment. It was clear that Company E was designated by the group as the taxpayer's employer in law. The Board did not accept that the first sentence in the SH Contract was sufficient to terminate the

HK Contract and it was not binding on Company E. The Board found that at all material times, the taxpayer was employed under the HK Contract, though she was sent to head Branch G2. Given the terms of the HK Contract, the Board had no doubt that the taxpayer was subject to a Hong Kong Employment, or in another word, that the source of her income was Hong Kong.

2. The Board had not lost sight of the fact that the taxpayer was interviewed in Country D, but the place of negotiation is only one of many facts that need to be considered. Further, the Board believed it was only significant where one or more of the contracting parties are non-Hong Kong resident or entity, which was not the case with the HK Contract.

3. The fact that the taxpayer rendered her services exclusively in Shanghai is relevant in considering whether the exemptions in sections 8(1A)(b) or 8(1A)(c) are applicable. They are not relevant in the enquiry into the source of income. Geopfert made it clear that in such an enquiry, the place where the employee rendered his services was not relevant and should be completely ignored. It is clear from the authorities that a person can be under a Hong Kong employment and yet renders his or her services wholly or partly outside Hong Kong. The locus of the employment and the place where services are rendered can be different.

4. The Assessor seemed to take the view that because the taxpayer was in Hong Kong for 82 days (i.e. more than 60 days) in the relevant year of assessment, she was thus liable to pay tax in Hong Kong subject to an exclusion of the number of days she was outside Hong Kong. The Board thought that the Assessor had confused the '60 days rule' with the 'day in day out formula'. They are completely different issues and should be addressed separately. The Board took the view that the correct reasoning should be as follows: (1) The taxpayer is liable to Salaries Tax in Hong Kong not because she was in Hong Kong for more than 60 days. She is liable because her employment with Company E was a Hong Kong employment. (2) The '60 days rule' is relevant in deciding whether her income is exempted from this liability by section 8(1A)(b). It is not so exempted because the Appellant visited Hong Kong for 82 days. (3) The next question then is whether the income is exempted by section 8(1A)(c). For this exemption to apply, 3 requirements (i.e. the income was derived from services overseas; the income was chargeable to tax of a similar nature to salaries tax; and the Commissioner is satisfied that the person had paid tax of that nature in that territory in respect of the income) have to be satisfied. (4) None of the 3 requirements has any correlation with the number of days the taxpayer may fortuitously happen to be in or out of Hong Kong. The Board was satisfied that the 2 sums satisfy the 3 requirements and should be excluded.

Appeal allowed in part.

Cases referred to:

Commissioner of Inland Revenue v George Andrew Geopfert [1987] HKLR 888, 2 HKTC 210
Lee Hung Kwong v Commissioner of Inland Revenue [2005] 4 HKLRD 80
Commissioner of Inland Revenue v So Chak Kwong, Jack, 2 HKTC 174
Varnam v Deeble [1985] STC 308
Coxon v Williams [1988] STC 593
Leonard v Blanchard [1993] STC 259
D5/14, (2014-15) IRBRD, vol 29, 416
D28/04, IRBRD, vol 19, 226
D41/09, (2009-10) IRBRD, vol 24, 780
D42/12, (2012-13) IRBRD, vol 27, 881
D17/04, IRBRD, vol 19, 145
BR 49/08 (unreported)
D34/01, IRBRD, vol 16, 303

Ivan T Y Cheung, Counsel, instructed by Messrs Wong & Co, for the Appellant.
Katherine Chan, Government Counsel and Edith Tam, Government Counsel of Department of Justice, for the Commissioner of Inland Revenue.

Decision:

1. The Appellant objected to the Salaries Tax Assessment raised on her for the year of assessment 2010/11.

2. By Determination dated 27 April 2017 ('the Determination'), the Deputy Commissioner of Inland Revenue ('the Commissioner') confirmed the Assessor's revised assessment (see paragraph 39 below).

3. By Notice of Appeal dated 24 May 2017, the Appellant appealed against the Determination. She argued (1) that her employment was a non-Hong Kong employment, or alternatively (2) that her income fell within the exemption under section 8(1A)(c) of the Inland Revenue Ordinance, Chapter 112 ('IRO'). For reasons to be set out below, we find that the Appellant fails on ground (1), but succeeds on ground (2).

The Evidence

4. The Appellant filed a witness statement and she gave evidence at the hearing before this Board. We find her a largely honest witness trying to state the facts as best she could. But as shall be pointed out below, there were a number of places where she had misinterpreted or misunderstood the facts. Further, insofar as there were inconsistencies

between her evidence and the documents, we prefer the documents.

The Facts

5. Much of the facts stated in the Determination are not disputed. On the basis of those facts and the documents and evidence before us, we find the facts stated in paragraphs 7 to 45 below as true and correct.

6. Unless otherwise stated, references to Appendices herein are references to Appendices to the Determination.

7. Company A was owned by Company B which in 2006 merged with Company C and became Company A1 headquartered in Country D. It offers marketing and advertising services worldwide including the Asia Pacific region. Its Greater China business covered Taiwan, the Mainland of China ('the Mainland') and Hong Kong.

8. Its Hong Kong subsidiary was Company E, a private company incorporated in Hong Kong with a business address in Hong Kong.

9. During the period from 1 January 2011 to 16 January 2014, the Appellant was one of the directors of Company E.

10. The Mainland subsidiary was Company F, incorporated in the Mainland as a foreign investment enterprise. Company F maintained a branch at Address G1 ('Branch G2'). For ease of reference, unless otherwise stated, references to Company F shall include references to Branch G2.

11. Operational-wise, Company E was one of the companies under Company F family/management group. The Appellant's evidence was that Company E was a small operation in comparison to Company F. 90% of the group's business profits in the Greater China region was generated by Company F.

The HK Contract

12. By a letter dated 4 June 2010, Company E offered to employ the Appellant as Position H and Position J on the terms and conditions stated therein.

13. The Appellant was interviewed for the post by Mr K, Company A1's Position L, and Mr M, Company A1's Position N, in City P and City Q respectively. She then met with Mr S, Company A1's Position T, in City U to finalise the selection process.

14. The HK Contract was accepted and signed by the Appellant in Shanghai on 9 June 2010.

15. Mr S signed the HK Contract for and on behalf of Company E on 24 June 2010.

16. The following terms and conditions in the HK Contract are relevant:

(1) The Appellant would commence her employment on a date to be mutually agreed, but it was envisaged that the employment would commence no later than 1 July 2010. The probationary period was three months. (Clause 1.1)

(2) The Appellant would report directly to Mr S or such other person as Company E might designate. Locations within the scope of the Appellant's responsibilities would include Shanghai, Hong Kong, Qingdao, Taipei and any new operations in Greater China. (Clause 2.1)

(3) Company E might require the Appellant (as part of her duties of employment) to perform duties or services not only for Company E but also for any affiliate where such duties or services were of a similar status to or consistent with her position with Company E. (Clause 2.3)

(4) The Appellant would be based predominantly in Shanghai and Hong Kong. (Clause 4.1)

(5) The Appellant's basic salary was RMB2,389,484 per annum, less any withholding required under her Individual Income Tax ('IIT') obligations for the Mainland and any other deductions required under applicable law. (Clause 5.1)

(6) The Appellant would be eligible to participate in the group's annual Senior Executive Incentive Plan ('SEIP'). Payments under the SEIP were at Company E's discretion. (Clause 5.3)

(7) Company E would provide gross housing allowance and gross cost of living allowance for the Appellant on reimbursement basis, up to maximum of RMB 128,008 and RMB22,810 per month respectively. (Clauses 6.1 and 6.2)

(8) The assignment benefits were intended to be available for the Appellant for the duration of any extended assignment to Shanghai. (Clause 6.6)

(9) If the Appellant relocated to Shanghai, Company E would provide air transportation for her and her spouse and pay the cost of actual expenses incurred to move a reasonable amount of her belongings to Shanghai. (Clauses 7.1 and 7.2)

(10) As an employee based in Hong Kong and Shanghai, the Appellant was eligible to observe public holidays in Hong Kong and the Mainland. (Clause 8.2)

(11) The Appellant enrolled in Company E's provident fund scheme. (Clause 10.1)

(12) The Appellant, her spouse and children were entitled to life insurance and medical benefits under Company E's policies. (Clauses 10.2 and 10.3)

(13) During the first month of the Appellant's probationary period, her employment might be terminated by either party without notice or payment in lieu of notice. After the first six months of her employment, the Appellant and Company E might terminate her employment with six months' notice or payment in lieu. (Clause 17.1)

(14) Company E reserved the right to exclude the Appellant from the premises of Company E and required her not to attend at work and/or not to undertake all or any of her employment duties at any time ('Leave Period') provided that the Leave Period would be of a reasonable duration and the Company would continue to pay her salary and contractual benefits for the duration of the Leave Period. (Clause 17.3)

(15) During any period of notice or Leave Period, the Appellant would remain an employee of Company E and could not act against the interests of Company E. (Clause 17.4)

(16) The Appellant would not, for six months (less the Leave Period) immediately following the termination date within the prohibited area, in competition with Company E directly or indirectly, be employed or engaged in the provision of services which were of the same or similar type to the services provided by Company E; solicit the business of the customers of Company E with whom the Appellant had dealings; and induce the persons employed by Company E to leave employment or to engage their services. (Clauses 18.1 to 18.3)

(17) The HK Contract was governed by and construed in accordance with Hong Kong laws. The terms of the Appellant's employment and any assignment would remain governed by Hong Kong laws throughout, to the exclusion of the laws of the Mainland. (Clause 21.4)

17. It is clear from these terms and conditions, in particular, Clauses 4.1, 5.1, 6.6 and 8.2, that it was envisaged that the Appellant would be sent to work in Branch G2.

The SH Contract

18. On 6 July 2010, the Appellant reported to work at Branch G2, and on the same day she signed an Employment Contract dated 6 July 2010 in Chinese with Company F ('the SH Contract'). It stated in the first sentence that the Appellant's labour relationship with Company E was terminated on 6 July 2010, and effective therefrom she was employed by Company F as Position H and Position J on the terms and conditions stated therein.

19. The SH Contract contained provisions for basic salary, SEIP, housing allowance and gross cost of living allowance, and annual leave and statutory holidays consistent with the HK Contract. But it lacks the extensive provisions that one would expect to find in a contract for someone in senior management.

20. The Appellant's evidence was that the SH Contract was based on a standard template which was used to write up the employment contracts of all the staff employed by Company F.

21. She further told us that as the legal representative (法人代表) of Company F, she was required by the law of the Mainland to have an employment contract with Company F. It was a requirement by law, so, if for example, Mr S were sent to head the Shanghai operation, he must also sign a contract with Company F. Likewise, if Company E seconded someone to work in the Shanghai operation, that person must also have a contract with Company F.

22. For reasons to be set out below, despite the first sentence in the SH Contract, we find that the HK Contract was not terminated or replaced by the SH Contract.

The Termination Letter

23. On 16 December 2013, the Appellant was asked to resign and was presented with the letter dated 16 December 2013 ('the Termination Letter'), by which Company E accepted the Appellant's resignation from her employment with Company E and her last day of employment would be 15 June 2014; and the Appellant confirmed her removal from any post, position, or office she might have with Company F. The Termination Letter contained, among others, the following terms and conditions:

(1) The Appellant would be on garden leave from 16 December 2013 to 15 June 2014 and had to comply with clauses 17.3 and 17.4 of the HK Contract. (Clause 1)

(2) In addition to her usual salary and benefits, Company E would pay the Appellant (i) statutory severance payment of HK$130,671 which comprised of severance payments in Hong Kong of HK$59,400 and in the Mainland of HK$71,271; and (ii) ex-gratia payment of RMB1,050,000. (Clause 2)

(3) The Appellant's entitlement under Company E's retirement scheme would be dealt with in accordance with the rules of the scheme. (Clause 4)

(4) The Appellant's acceptance of the payments and benefits provided in the Termination Letter was in full and final settlement of all claims against Company E and Company F and the Appellant released all claims which she might have if not for her agreement to the terms of the Termination Letter. (Clause 6)

(5) The Appellant would abide by her post-termination obligations under clause 18 of the HK Contract, which remained in full force and effect, after termination of her employment. (Clause 10)

(6) The Termination Letter constituted the entire understanding between the parties relating to its subject matter and superseded all prior negotiations, understandings and agreements. (Clause 12)

(7) The Termination Letter was governed by the laws of Hong Kong. (Clause 13)

24. Miss V, sent by Country D head office signed for and on behalf of Company E. The Appellant signed to confirm acceptance of the terms of the Termination Letter on the same day.

25. Company E filed a 'Notification by An Employer of An Employee Who is About to Cease to be Employed' in respect of the Appellant on 16 October 2014.

Other relevant factors

26. During her employment, the Appellant reported directly to Mr S until he left Company A1 in 2012, after which she reported to Mr K. She did not have any office space, direct line or secretarial support in Company E. Her name card listed Branch G2 only as her office address. She was not involved in any meetings with Hong Kong client, even top Hong Kong clients.

27. The Appellant was given full time driver, housing and business class travel allowances inside the Mainland. Her salary, after IIT deduction, was paid by Company F. This was confirmed by Company E.

Company W Agreement

28. Prior to her employment with Company E, the Appellant was employed by Company W. The Appellant supplied to the Assessor a Separation Agreement dated 19 January 2010 from Company W ('Company W Agreement') which acknowledged receipt of the Appellant's resignation letter dated 6 January 2010. The Appellant's evidence was that she was bound by a six months separation notice after the last working day with

Company W, so she could not commence any new employment until 6 July 2010, otherwise she would lose her ex gratia payment from Company W of over RMB2 million.

29. We accept this evidence. We accept that despite what was stated in the HK Contract, the Appellant only started work on 6 July 2010. We accept the Appellant's evidence that because the office of Position H and Position J had been vacant for 8 months, Mr S wanted to state in the HK Contract that the Appellant's employment was envisaged to commence no later than 1 July 2010 (despite knowing that the Appellant could not start work until 6 July) so that he could report to Country D management 'the good news'.

30. As shall be explained below (see paragraph 63 below), we find that it was to enable the Appellant to satisfy the Company W Agreement that the SH Contract started by stating that the Company E was terminated on 6 July 2010 when the parties knew this was not the case.

Employer's Return filed by Company E

31. Company E filed an Employer's Return of Remuneration and Pensions ('Employer's Return') for the year of assessment 2010/11 in respect of the Appellant reporting the following particulars:

(1) Income for the period from 1/7/2010 to 31/3/2011 including salary, bonus and allowance was HK$3,025,101.

(2) A place of residence in Shanghai was provided to the Appellant for the period from 1/7/2010 to 31/3/2011 by refunding all the rent she paid to the landlord in the amount of $1,334,940.

(3) The above reported income and rental refunds were wholly or partly paid to the Appellant by Company F.

32. Company E also duly filed an Employer's Return for the year of assessment 2013/14. In their letter of 22 August 2016 to the Assessor Company E explained that they had inadvertently omitted to file Employer's Returns for the years of assessment 2011/12 and 2012/13 but included the Appellant's income in the 2013/14 Employer's Return because there had been several changes in the responsible personnel. They submitted the 2011/12 and 2012/13 Employer's Returns and the revised 2013/14 Employer's Return with the letter.

Tax Return and documents submitted by the Appellant

33. In her Tax Return - Individuals for the year of assessment 2010/11, the Appellant did not declare any employment income and claimed income exemption on the following grounds:

(1) She derived income of RMB2,739,416 from her non-Hong Kong employment held with Company F.

(2) All services were rendered by her outside Hong Kong.

(3) She paid tax of RMB648,635.85 outside Hong Kong.

34. To support her income exemption claim, the Appellant provided the following documents:

(1) A letter dated 25 October 2011 issued by Human Resources Director of Company F to the Assessor and another letter dated 20 April 2012 issued by HR Director & Head of Administration of Branch G2 to the Inland Revenue Department, which stated, among others, the followings:

(i) The Appellant was employed by Company F under the SH Contract effective from 6 July 2010 and was permanently based in Shanghai.

(ii) The Appellant's employment income was solely paid by Company F.

(iii) As the Appellant spent more than 180 days a year in the Mainland, her monthly salaries were withheld for tax payments in the Mainland before payrolls were deposited into her Bank X account in Shanghai.

(iv) There was no office allocated to the Appellant in Hong Kong. She was not required to work physically in Hong Kong.

(v) The working terms would not change during the years 2012 and 2013.

(2) The Appellant's travel schedule for the months from July 2010 to March 2011, which showed that apart from Saturday/Sundays and public holidays:

(i) The Appellant spent a total of 7 days in Hong Kong to attend meetings and conference and to lunch with clients. (We are satisfied that these were part and parcel of the services she rendered for Branch G2.)

(ii) The Appellant spent a total of 7 days in Hong Kong on leave, out of which 5 days were spent as part of her annual leave and 2 days as sick leave.

(iii) The Appellant made 2 personal trips outside Hong Kong for a total of 17 days.

(3) Copies of monthly IIT Payment Certificates (中華人民共和國個人所得稅完稅證明) issued by Jing'an District Branch of Shanghai Municipal Bureau of Local Taxation (上海市地方稅務局靜安區分局), which showed that IIT in the total sum of RMB816,873.57 had been paid.

(4) A copy of the Appellant's work permit (通行證) issued by the Ministry of Human Resources and Social Security of the People's Republic of China (中華人民共和國人力資源和社會保障局) on 19 October 2010 and valid until 1 July 2015, which showed that her working unit (工作單位) was Branch G2.

(5) A copy of the corporate legal person business license (企業法人營業執照) of Company F dated 20 January 2011, which showed that the Appellant was the legal representative (法定代表人) of Company F.

(6) A copy of the business License (營業執照) of Branch G2 dated 30 March 2011, which showed that the Appellant was the responsible person (負責人) of Branch G2.

35. The Assessor rejected the Appellant's claim for full exemption of her income and made an assessment of salaries tax on her income.

36. The Appellant objected to the assessment and in support of her objection, provided a letter dated 6 June 2013 issued by Company F, which stated, among others, that the Appellant did not render any services in Hong Kong and was required to pay IIT in respect of her employment income in the Mainland. There followed further correspondence between the Appellant's tax representative and the Assessor.

Enquiries by the Assessor

37. The Assessor made enquiries with Company E by various letters in 2014 and 2016. Company F, on behalf of Company E, replied to the enquiries and provided further information to the Assessor.

38. Company E confirmed that:

(1) The Appellant's employment with Company E for the period from 1 July 2010 to 31 March 2011 was governed by the HK Contract. In support thereof, Company E supplied the Assessor with the HK Contract and the Termination Letter.

(2) The last day of her employment with Company E was 15 June 2014.

(3) The Appellant's remuneration was paid by Branch G2. It was neither reimbursed nor borne by Company E. It was not charged in the profits and loss accounts of Company E and had not been claimed as Company E's deductible expenses for Hong Kong tax purposes.

(4) The Appellant was enrolled in Company E's provident fund scheme in accordance with the MPF requirements of Hong Kong. In support thereof, Company E supplied a letter with schedule issued by Company Y, which showed that the Appellant was enrolled in Company Z MPF Plan-Advanced with a monthly contribution of $1,000 each by the employer (i.e. Company E) and the employee (i.e. the Appellant) from 1 July 2010 to 30 June 2014.

39. It was on the basis of this information that the Assessor subsequently revised the initial assessment to allow for the contributions in the total sum of $8,000 (i.e. July 2010 to March 2011). The revised assessment ('Revised 2010/11 Assessment') was as follows:

		$
Income from Company E [Fact (6)(a)]		3,025,101
Less:	Income excluded [$3,025,101 x (274 - 82)/274]	2,119,779
		905,322
Add:	Value of residence provided	90,532
		995,854
Less:	Retirement scheme contributions	8,000
		987,854
Less:	Total allowances	266,000
Net Chargeable Income		721,854
Tax Payable thereon (after tax reduction)		104,715

40. The sum of HK$3,025,101 was based on the Employer's Return 2010/2011 and was composed as follows:

	HK$	RMB
Salary	2,076,574	*1,742,113.03*
Bonus	662,842	*572,042.40*
Other Allowances	285,685	
	3,025,101	

41. Regarding the formula adopted by the Assessor in excluding $2,119,779 from the income, '**274**' was the number of days from 1 July 2010 to 31 March 2011 and '**82**' was the number of days the Appellant was in Hong Kong during that period according to Arrival and Departure Records from the Immigration Department. So in

effect the Assessor adopted a 'day out' formula to apportion the sum for exclusion from her income.

42. In paragraphs 23 to 156 of her Witness Statement, the Appellant explained in meticulous details why she came back to Hong Kong in the 82 days, predominantly for personal purposes. The Appellant was and is a Hong Kong resident. Her husband and teenage son (at that time) lived in Hong Kong and her son went to school in Hong Kong. Her parents also lived in Hong Kong. We accept her evidence as to these visits to Hong Kong.

IIT paid in the Mainland

43. We are satisfied that in respect of the sums of HK$2,076,574 (*RMB1,742,113.03*) and HK$662,842 (*RMB572,042.40*), the Appellant had already paid IIT in the Mainland:

(1) It was the Appellant's evidence that it was the law and practice in the Mainland that tax was withheld by the employer, i.e. Company F, before the salary or bonus was paid out to her.

(2) The withhold of tax was confirmed in the letters issued by Company F to the Assessor/Commissioner.

(3) The IIT Payment Certificates evidenced that IIT at RMB72,070.65 per month from July 2010 to February 2011 and RMB240,308.37 for the month of March 2011, making a total of RMB816,873.57, had been paid.

(4) The IIT for March 2011 was a much larger sum because of the bonus of RMB572,042.40 awarded to the Appellant in that month. As evidenced by the table supplied by Company E, the IIT for the bonus was RMB168,237.72. Together with the IIT on the monthly salary, the total IIT for March 2011 was RMB168,237.72 + 72,070.65 = 240,308.37.

44. So in apportioning the Appellant's income on a 'day out' formula, part of the Appellant's income became subject to taxation both in the Mainland and in Hong Kong. For reasons to be set out below, this Board considers this approach unfair and it ignores the exemption provided by section 8(1A)(c) of the IRO.

45. The Revised 2010/11 Assessment was confirmed by the Commissioner in the Determination. Dissatisfied with the Determination, the Appellant appealed to this Board.

Relevant Statutory Provisions

46. Section 8(1)(a) of IRO stipulates that '*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 ... any office or employment of profit*'.

47. Section 8(1A) of the IRO stipulates:

> '*(1A) For the purposes of this Part, income arising in or derived from Hong Kong from any employment-*
>
> *(a) includes, without in any way limiting the meaning of the expression and subject to paragraph (b), all income derived from services rendered in Hong Kong Including leave pay attributable to such services;*
>
> *(b) excludes income derived from services rendered by a person who-*
>
> *(i) is not employed by the Government or as master or member of the crew of a ship or as commander or member of the crew of an aircraft; and*
>
> *(ii) renders outside Hong Kong all the services in connection with his employment; and*
>
> *(c) excludes income derived by a person from services rendered by him in any territory outside Hong Kong where-*
>
> *(i) by the laws of the territory where the services are rendered, the income is chargeable to tax of substantially the same nature as salaries tax under this Ordinance; and*
>
> *(ii) the Commissioner is satisfied that that person has, by deduction or otherwise, paid tax of that nature in that territory in respect of the income.*'

48. Section 8(1B) of the IRO stipulates that '*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.*'

Relevant Authorities

49. We refer to the following authorities on the determination of the source of income:

(1) CIR v George Andrew Geopfert [1987] HKLR 888, 2 HKTC 210, Macdougall J;

(2) Lee Hung Kwong v CIR [2005] 4 HKLRD 80, Deputy Judge To;

50. The followings are clear from Geopfert:

(1) Section 8(1) imposes a basic charge to salaries tax.

(2) In the enquiry under section 8(1) as to whether his income arose in or was derived from Hong Kong, the place where the employee renders his services is not relevant. It should be completely ignored [Geopfert, HKLR 901E, HKTC 236; Lee Hung Kwong, 89J].

(3) It is necessary to look for the place where the income really comes to the employee, that is to say, where the source of income (the employment) is located. Regards 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 [Geopfert, HKLR 901J, Lee Hung Kwong, 91B].

(4) 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 connexion. He is entitled to scrutinise all evidence, documentary or otherwise, that is relevant to this matter. The so called 'totality of facts' test is descriptive of the process adopted to ascertain the true answer to this question [Geopfert, HKLR 901-902, HKTC 237].

(5) Once it is decided that the source of income is Hong Kong so that it is caught by section 8(1), then there is no provision for apportionment [Geopfert, HKLR 902, HKTC 238]. His entire salary is subject to salaries tax wherever his services may have been rendered, unless

(i) he can claim relief by way of exemption under section 8(1A)(b) as read with section 8(1B) [Geopfert, HKLR 902I], i.e. he performed all of his services overseas (section 8(1A)(b)), and in determining whether he performed all of his services overseas, period of less than 60 days in Hong Kong are to be disregarded

(section 8(1B)) – the so called '60 days rule'; or

(ii) he satisfies section 8(1A)(c) and pays tax in another country.

(6) Section 8(1A)(a) creates a liability to tax additional to the section 8(1) basic charge. It is an extension to the basic charge. It brings into the charge income from a source outside Hong Kong if the services were rendered in Hong Kong [Geopfert, HKLR 901D, HKTC 236; Lee Hung Kwong, 89F].

(7) Income brought within this extended charge depends on the number of days the services were rendered in Hong Kong, i.e. it can be apportioned on a 'time in time out' basis (another expression for the 'day in day out' formula adopted in the present case). So in Geopfert, the finding of facts was that the employment was a non-Hong Kong employment, but the taxpayer rendered all his services in Hong Kong except for 41 days. He was held liable to salaries tax in Hong Kong except for the 41 days. [Geopfert, HKLR 902I, HKTC 238].

(8) The court went on to find that section 8(1A)(a) was also subject to the '60 days rule' [Geopfert, HKLR 903A, HKTC 238-239]. It opined that had the taxpayer merely earned income from services rendered in Hong Kong during visits not exceeding a total of 60 days in the year of assessment, then by virtue of section 8(1A)(b)(ii) read with section 8(1B), that income would be exempt from liability to salaries tax.

51. For us, the findings in Geopfert are clear except for the applicability of the '60 days rule' to section 8(1A)(a). To summarise the findings in vernacular:

(1) Section 8(1) imposes a basic charge – Hong Kong employment and Hong Kong tax is payable. There is no question of apportionment.

(2) Section 8(1A)(a) extends the basic charge – it catches non-Hong Kong employment but the services are rendered inside Hong Kong. There is apportionment of the income chargeable on a "time in time out" basis.

(3) Section 8(1A)(b) is a reverse of section 8(1A)(a) – it covers the case of a Hong Kong employment but all services are rendered outside Hong Kong. The '60 days rule' is applicable to determine whether 'all services are rendered outside Hong Kong' or not.

52. On the applicability of the '60 days rule' to section 8(1A)(a), Geopfert seemed to take the view that the extended charge to non-Hong Kong employment could also enjoy the benefit of the section 8(1A)(b) exemption, and thus subject to the '60 days rule'. We think this might have confused the intent and purposes of two subsections – one

covers non-Hong Kong employment and the other Hong Kong employment. Irrespectively, it is not necessary for us to explore this for our present purposes.

53. For present purposes, it suffices for us to note that when discussing the applicability of the '60 days rule' in Geopfert, nowhere did the court make any reference to the exemption in section 8(1A)(c).

54. On the interpretation of the '60 day rule', we were referred to CIR v So Chak Kwong, Jack, 2 HKTC, 174, Mortimer J. In that case the taxpayer was an employee of a Hong Kong based company but was seconded to work in the United Kingdom. He spent a total of 108 days in Hong Kong but only 28 days were spent rendering services in connection with his employment. He claimed exemption under section 8(1A)(b) and 8(1B). It was held that the words 'not exceeding a total of 60 days' in section 8(1B) qualified the words 'visit' and not the words 'services rendered'. The taxpayer was thus not entitled to take advantage of the exemption. The taxpayer there did not make any claim under section 8(1A)(c).

The Grounds Of Appeal

55. The Appellant raised two Grounds of Appeal. Essentially, the Appellant argued that:

(1) The employment was a non-Hong Kong employment; and

(2) The exemption in section 8(1A)(c) applied.

Our Decision

Whether a non-Hong Kong Employment

56. In support of her contention that the employment was a non-Hong Kong employment, Mr Cheung representing the Appellant argued that the Appellant was employed neither by Company E nor Company F, but by Company A1. He relied on the followings:

(1) She negotiated her employment with the head office in Country D (see paragraph 13 above).

(2) She reported duty directly to Mr S and subsequently to Mr K.

(3) The HK Contract, the SH Contract and the Termination Letter all bore the logo of Company A1.

57. We reject this argument. As Position H and Position J and reporting directly to Company A1, we can understand why the Appellant should regard herself as part of the top management team of the group headed by Company A1. But it is clear that Company E was designated by the group as the Appellant's employer and in law, Company E was her

employer:

(1) The HK Contract started by stating 'We are pleased to formally offer you employment with Company E ("the Company") ...'

(2) Mr S signed the HK Contract 'for and on behalf of' Company E.

(3) Letters from Company E in reply to enquiries by the Assessor confirmed that the Appellant was employed by Company E for the period from 1 July 2010 to 31 March 2011 under the HK Contract.

(4) The Termination Letter started by stating 'We are writing to accept your resignation of employment from Company E ("the Company"). Your last day of employment will be 15 June 2014 ("the Last Date"). Your employment and contractual benefits will cease on the Last Date …'

58. The Appellant further argued that the HK Contract had been terminated and replaced by the SH Contract. She pointed to the first sentence in the SH Contract. We do not accept that this sentence was sufficient to terminate the HK Contract. This one sentence included in the SH Contract between the Appellant and Company F (or Branch G2) was not binding on Company E. We repeat paragraphs 57(3) and (4) above.

59. A comparison of the HK Contract with the SH Contract shows that the HK Contract was a far more comprehensive document. The HK Contract ran into 11 full pages whereas the SH Contract was only 2 pages long. As said by the Appellant herself, the SH Contract was built on a template applicable to all the staff in Company F. It did not contain all the terms that one would expect to find in an employment contract of someone in senior management. Restrictions regarding confidential information, copyright and patents, exclusivity of services, receipt of payments and benefits from third parties and termination of employment (Clauses 12 to 18 of the HK Contract) are important safeguards to the employer. They were all missing in the SH Contract.

60. When asked about the Company W Agreement, the Appellant herself made the point that a 'non-compete clause' was very common in employment contracts of someone in her position. Yet such a clause was singularly lacking in the SH Contract. In the Termination Letter, Company E had to fall back on Clause 18 of the HK Contract for such a restriction to operate (see Clause 10 of the Termination Letter).

61. The provision for Leave Period (Clause 17 of the HK Contract) was also an important provision relied on in the Termination Letter (sec Clause 1 of the Termination Agreement). As the Appellant told us, Miss V made her sign the Termination Letter on the same day it was presented to her and within an hour the Appellant was required to leave the premises and she was no longer allowed access to her email or other documents. Thereafter she was put on garden leave. This, again, would be a common scenario when senior personnel resigned, to prevent loss of client and other confidential information of the company. Provision for garden leave was likewise lacking in the SH Contract and the

Termination Letter had to fall back on the HK Contract.

62. It defies commercial sense that Company E or the group headed by Company A1 would be content to cancel the HK Contract and let the Appellant be employed on the bare terms of the SH Contract. The SH Contract was signed not to replace the HK Contract and the Appellant knew that. It was signed because, as the Appellant herself told us, it was the law of the Mainland that as legal representative of Company F, it was a legal requirement in the Mainland that she must have an employment contract with Company F.

63. As to the first sentence of the SH Contract, we believe it was put there to enable the Appellant to satisfy the Company W Contract and get her ex gratia payment, not to terminate or replace the HK Contract.

64. We find that at all material times, the Appellant was employed under HK Contract, though she was sent to head Branch G2. She continued to be bound by the HK Contract and she also enjoyed its benefits including the MPF entitlement. The HK Contract remained binding and subsisting until the last day of her employment, namely 15 June 2014, and her employment was terminated on the terms of the HK Contract.

65. Given the terms of the HK Contract, we have no doubt that the Appellant was subject to a Hong Kong employment, or in another word, that the source of her income was Hong Kong.

66. We have not lost sight of the fact that the Appellant was interviewed in Country D, but the place of negotiation is only one of many facts that need to be considered. Further, we believe it is only significant where one or more of the contracting parties are non-Hong Kong resident or entity, which is not the case with the HK Contract.

67. The Appellant further pointed to these facts:

(1) She rendered her services exclusively in Shanghai save for 7 occasions when she attended meetings and conference and lunched with clients in Hong Kong.

(2) She had no office, secretarial support, direct line, name card or any other support in Company E.

(3) The Appellant's salaries were paid by Company F, not Company E.

68. Points (2) and (3) are corollaries of Point (1), i.e. that she rendered her services exclusively in Shanghai. These points are relevant in considering whether the exemptions in sections 8(1A)(b) or 8(1A)(c) are applicable (see below). They are not relevant in the enquiry into the source of income. Geopfert made it clear that in such an enquiry, the place where the employee rendered his services was not relevant and should be completely ignored. It is clear from the authorities that a person can be under a Hong Kong employment and yet renders his or her services wholly or partly outside Hong Kong (see e.g.

CIR v So Chak Kwong, Jack, ibid). The locus of the employment and the place where services are rendered can be different.

69. In all circumstances, we find that the Appellant fails on the first ground of appeal.

Exemption under section 8(1A)(c)

70. We find that the exemption is applicable in respect of her salary and bonus.

71. The Assessor seemed to take the view that because the Appellant was in Hong Kong for 82 days (i.e. more than 60 days) in the relevant year of assessment, she was thus liable to pay tax in Hong Kong subject to an exclusion of the number of days she was outside Hong Kong.

72. We think the Assessor has confused the '60 days rule' with the 'day in day out formula'. They are completely different issues and should be addressed separately. In Geopfert, the court approved a 'day in day out formula' for the extended liability under section 8(1A)(a), but made no reference to such an apportionment for the exemptions in sections 8(1A)(b) and 8(1A)(c).

73. We asked Miss Chan representing the Commissioner if she had authorities to support the Assessor's approach. She sought support from three English cases (Varnam v Deeble [1985] STC 308, CA; Coxon v Williams [1988] STC 593; Leonard v Blanchard [1993] STC 259, CA), but these cases concerned fiscal provisions in England which did not have a '60 days rule' and which spoke of 'qualifying days'. By definition, it involved the counting of days, in that case, a 'day out formula' - the number of days the taxpayer worked outside of England. The English provision is not comparable to the exemption in section 8(1A)(c).

74. Turning to the Hong Kong Board of Review Cases:

(1) In D5/14, (2014-15) IRBRD, vol 29, 416, the exemption under section 8(1A)(c) was not in issue [paragraph 36, IRBRD 436].

(2) D28/04, IRBRD, vol 19, 226 and D41/09, (2009-10) IRBRD, vol 24, 780 were decisions on section 8(1A)(a). They concerned taxpayers employed under a non-Hong Kong employment, but rendered part of their services in Hong Kong. In such cases, a 'day in day out' apportionment was approved in Geopfert (see paragraph 50(7) above).

(3) In D42/12, (2012-13) IRBRD vol 27, 881, the taxpayer paid zero salary tax in Country D where he rendered his services and it was on this basis that the Board there found that not all three requirements of Section 8(1A)(c) were satisfied [paragraph 17, IRBRD 896].

(4) In D17/04, IRBRD, vol 19, 145, the Board found that the taxpayer had failed to prove the entirety of his income, but only part of it in the sum of $520,934, was derived from services rendered by him in the Mainland [paragraphs 9(d) to (f), pages 149-151]. It was held that only the sum of $520,934 fell within the exemption [paragraph 11, page 151]. Nowhere in that case did the Board adopt a 'day in day out' formula.

(5) BR 49/08, (unreported) was the only decision which seemed to support the 'day in day out' formula adopted by the Assessor in considering a section 8(1A)(c) exemption. We note that this is an unreported decision, so only the Commissioner has access to this decision.

75. The reasoning in BR 49/08 was not clear and we decline to follow it. 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. We prefer the approach in D17/04 and D42/12 (and they both refer to an earlier decision of the Board in D34/01).

76. We note that in all three cases, the Board referred to the '60 days rule' in connection with the exemption in section 8(1A)(b), not section 8(1A)(c) [see D34/01, paragraph 23; D42/12, paragraphs 13-15; D17/04, paragraph 7].

77. In connection with section 8(1A)(c), these three cases referred to three requirements:

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

(ii) that the income was chargeable to tax of a similar nature to salaries tax; and

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

78. These 3 requirements in effect repeat the plain language of section 8(1A)(c).

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

(1) The Appellant is liable to Salaries Tax in Hong Kong not because she was in Hong Kong for more than 60 days. She is liable because her employment with Company E was a Hong Kong employment. That is the basis of her liability.

(2) The '60 days rule' is relevant in deciding whether her income is exempted from this liability by section 8(1A)(b). It is not so exempted

because the Appellant visited Hong Kong for 82 days.

(3) The next question then is whether the income is exempted by section 8(1A)(c). For this exemption to apply, three requirements as stated above have to be satisfied.

(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.

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 three requirements. It is then a question of facts and evidence what part of the income satisfies the three requirements. For example:

(1) In D17/04, the Board found that the taxpayer could prove that part of his income in the sum of $520,934 was derived from services rendered by him in the Mainland (i.e. requirement (i)) [paragraphs 9(d) to (f), pages 149-151]. So this sum and this sum only fell within the exemption [paragraph 11, page 151].

(2) In D34/01, the Board found that the taxpayer had only declared part of his income to the tax authorities in the Mainland (i.e. requirement (ii)) and so only this amount fell within the exemption [paragraph 30, D34/01]. The undeclared portion (i.e. the hardship allowance) was not exempt.

81. D34/01 considered that the Commissioner had the power and indeed the duty to ascertain the income (including hardship allowance, if any) which the taxpayer had reported to the Chinese tax authorities before deciding whether section 8(1A)(c)(ii) was satisfied [paragraph 29, D34/01]. Likewise in the present case the Assessor had a duty to direct his mind to the three 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.

82. In this connection, the points raised by the Appellant that she rendered her services exclusively in Shanghai; that she had no office, secretarial support, direct line, name card or any other support in Company E; and that her salaries were paid by Company F, not Company E, become important considerations.

83. The Appellant earned a regular monthly salary. Her salary was paid to her by Company F at a constant rate each month for her work as head of the Shanghai operation.

The bonus paid to her at the end of the year clearly depended on her performance in that position.

84. The Appellant frankly admitted that there were 7 occasions during her visits to Hong Kong when she did 'work' as opposed to purely personal pursuits. Such works included lunching with a client, attending conference and sitting in a meeting. We accept that these works were minimal and peripheral and had no impact on her salary and bonus in any way.

85. In return for her services in Branch G2, she received total monthly salary and year-end bonus in the sum of HK$2,076,574 (or *RMB1,742113.03*) and HK$662,842 (or *RMB572,042.40*) respectively. We find as a fact that these 2 sums were income derived by the Appellant from services rendered by her in the Shanghai operation. No part of this salary or bonus was derived from services rendered in Hong Kong. They satisfy requirement (i).

86. We further find as facts that she had paid IIT in respect of these 2 sums and that IIT was of substantially the same nature as salaries tax under the IRO.

87. In the premises, we are satisfied that these 2 sums satisfy the three requirements and should be excluded:

(1) They were income derived by the Appellant from services rendered by her in the Mainland outside of Hong Kong;

(2) By the laws of the Mainland, the income was chargeable to tax, i.e. IIT, which was of substantially the same nature as salaries tax under the IRO; and

(3) The Appellant had paid IIT in respect of the income.

88. As regards 'Other Allowances' in the sum of HK$285,685, there is no evidence that IIT has been paid in respect of this sum. So similar to D34/01, requirement (ii) is not satisfied and this sum will not be exempted unless the Appellant can produce further evidence to prove otherwise.

Conclusion

89. In conclusion:

(1) We find that the Appellant was at all material times employed under the HK Contract. Her employment was a Hong Kong employment and her income thereunder was income arising in or derived from Hong Kong within the meaning of section 8(l) of the IRO. It was subject to salaries tax in Hong Kong save and insofar as any part thereof was excluded by section 8(1A)(c).

(2) We find that out of the total income of HK$3,025,101, the sums of HK$2,076,574 and HK$662,842 were excluded by section 8(1A)(c).

90. In the premises, we dismiss ground (1) but allow ground (2) of the grounds of appeal.

91. In accordance with section 68(8) of the IRO, we order as follows:

The Revised 2010/11 Assessment is annulled and the case is remitted to the Commissioner with the opinion of the Board that out of the total income of HK$3,025,101, the sums of HK$2,076,574 and HK$662,842 are excluded by section 8(1A)(c) of the IRO, and that the Commissioner has the power and the duty to ascertain whether 'Other Allowances' in the sum of HK$285,685 satisfy the three requirements in section 8(1A)(c).