

**Case No. D3/20**

**Salaries tax** – remuneration under certain agreements – whether income derived from an employment of profit – whether artificial or fictitious – sections 9A, 61 of IRO

Panel: Anson Wong SC (chairman), Shun Yan Edward Fan and Miu Liong Nelson.

Dates of hearing: 18-19 October 2016.

Date of decision: 26 May 2020.

The Taxpayer and his wife are shareholders and directors of Company A.

Company A provided pre-floatation consultant services to Company B and its affiliated companies from 1 February 2002 to 31 March 2007.

Pursuant to section 9A, the Assessor considered that the management fees income of Company A from Company B, was the Taxpayer's employment income.

The Assessor raised on the Taxpayer the Additional Salaries Tax Assessment for year of assessment 2001/02 to 2006/07 (the 'Additional Assessments').

The Commissioner took the view that the true relationship between the Taxpayer and Company B was in substance one of employment and section 9A(4) is inapplicable.

Alternatively, the Commissioner opined that the interposition of Company A between the Taxpayer and Company B was a transaction caught by section 61, which is 'artificial or fictitious or is not in fact given effect to'.

The Taxpayer appeals.

**Held:**

1. The Board does not need to be concerned about the question whether the Taxpayer was in substance holding an 'office' in Company B within the meaning of section 9A(4).
2. The Board finds that the carrying out of the pre-floatation consultant services by the Taxpayer of Company A was not in substance an employment with Company B. The Taxpayer should not be chargeable to Salaries Tax under section 9A(1).
3. The Board does not consider that the interposition of Company A can be

said to be ‘artificial’.

**Appeal allowed.**

Cases referred to:

Edwards v Clinch [1982] AC 845  
Poon Chun Nam v Yim Siu Cheung (2007) 10 HKCFAR 156  
Market Investigations Ltd v Minister of Social Security [1969] 2 QB 173  
Lee Ting Sang v Cheung Chi Keung [1990] 1 HKLR 764  
D13/06, (2006-07) IRBRD, vol 21, 341  
Abdalla v Viewdaze Party Ltd 53 ATR 30  
Seramco Limited Superannuation Fund Trustees v Income Tax Commissioner [1997] AC 287  
Commissioner of Taxpayer Audit and Assessment v Cigarette Co of Jamaica Ltd (in liquidation) [2012] 1 WLR 1794  
Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773

Co Dixon Yau Tik, Counsel, instructed by Messrs Cheng & Cheng Taxation Services Ltd., for the Appellant.

Katherine Chan, Government Counsel, Suen Sze Yik, Senior Government Counsel and Edith Tam, Government Counsel, of the Department of Justice, for the Commissioner of Inland Revenue.

**Decision:**

**A. Introduction**

1. In this appeal, the Taxpayer appeals against the determination of the Commissioner of the Inland Revenue Department (the ‘Commissioner’) dated 7 September 2015 (the ‘Determination’) in which the Commissioner rejected the Taxpayer’s objections against the Additional Salaries Tax Assessments for the years of assessment 2001/02 to 2006/07 raised on him.

2. Save for some minor corrections<sup>1</sup>, the factual matters set out in paragraphs 1(1) to 1(37) of the Determination are not in dispute. The salient features of the factual background that are relevant to this appeal will be summarised in Section B below.

**B. Factual Background**

3. The Taxpayer and his wife (‘Wife’) are shareholders and directors of

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<sup>1</sup> The corrections are set out in a document titled ‘Facts in the Determination’ dated 19 October 2016 submitted by the parties.

(2020-21) VOLUME 35 INLAND REVENUE BOARD OF REVIEW DECISIONS

Company A, a company incorporated in Hong Kong in March 1990.

4. On 4 February 2002, the Taxpayer on behalf of Company A issued a letter to Company B titled 'Proposal for management consultation services to be provided by [the Taxpayer] of [Company A]' (the '2002 Proposal').

5. Company B, a company incorporated in Hong Kong in 1973, was at the material time engaged in the principal business of production and trading of wooden furniture. At the material time, the President of Company B was Mr C whereas the Chief Executive Officer of Company B was Mr D.

6. Under the 2002 Proposal, which was countersigned by Company B to indicate its acknowledgment and approval, management consultant services were to be provided by the Taxpayer of Company A to Company B and its affiliated companies for a period of 14 months from 1 February 2002. The 2002 Proposal contained, *inter alia*, the following terms:

- (1) 'The objectives of [Company A] assigning its Chief Consultant, [the Taxpayer], to [Company B] on full time basis are as follows:-
  1. To provide full-time consultation service of [Mr D], Chief Executive Officer of [Company B] and the Group from Monday to Friday, except public holidays and bank holidays, observing the Company's normal working hours and working days;
  2. To assume executive role of [Company B], e.g. [Position E] of [Mr D's] organisation and the Group, as appropriate and Chief Financial Controller of [Company B];
  3. The area of responsibilities to cover, but not limited to, review of the organization's financial and operation systems; recommendation and implementation of efficient financial controlling and operation systems;
  4. Any other related or appropriate management advice and services from time to time.'
- (2) 'The term of this management project is initially set for fourteen (14) months commencing on 1 February 2002 until 31 March 2003. However, either party may terminate this management agreement by giving to the other party prior written notice of not less than two (2) calendar months. Three (3) months prior to the expiration of this management agreement, both parties may consider to mutually renew the management agreement for a further term of twelve (12) months at a mutually agreed management fee.'
- (3) 'Monthly management fee of HK\$60,000 will be charged by

(2020-21) VOLUME 35 INLAND REVENUE BOARD OF REVIEW DECISIONS

[Company A]. Invoice for the monthly management fee will be issued in the first week of each calendar month and it is due for payment upon receipt by [Company B] or its authorised officer.'

- (4) 'Upon termination or expiration of the Contract, [Company B] will also pay to [Company A], a termination fee of not less than 10% of the total management fee charged throughout the period of this Project.'
- (5) 'Should [Mr D] / [Company B] require [Company A] / [the Taxpayer] to provide other professional services than the Project mentioned herein, separate arrangements and agreements will be negotiated separately and mutually agreed.'

7. In addition to the 2002 Proposal, the Taxpayer on behalf of Company A issued another letter to Company B titled 'Agreement for management consultation services to be provided by [Company A]' (the '2002 Agreement'), which was also countersigned by Company B to indicate its acknowledgment and approval of the same.

8. The 2002 Agreement contained, *inter alia*, the following terms:

- (1) '[Company A] agrees to provide management services to [Company B] and its affiliated companies. Accordingly, [Company A] has assigned its Consultant on the project for a period of 14 months.'
- (2) 'The objective of the project is to assist [Company B] in preparation for listing of its shares in the Stock Exchange. As such, [Company A], headed by its Consultant, will provide pre-floatation consultation services to [Company B] follows:-
  1. To provide consultation service of [Mr D], Director of [Company B] and the Group;
  2. The area of responsibilities to cover, but not limited to, review of the organization's financial and operation systems; recommendation and implementation of efficient financial controlling and operation systems;
  3. Any other related or appropriate management advice and services from time to time.'
- (3) 'The term of this management project is initially set for fourteen (14) months commencing on 1 February 2002 until 31 March 2003. However, if the Company should decide not to pursue public listing, it may terminate this management agreement by giving to [Company A] prior written notice of not less than two (2) calendar months. Three (3) months prior to the expiration of this management

(2020-21) VOLUME 35 INLAND REVENUE BOARD OF REVIEW DECISIONS

agreement, both parties may consider to mutually renew the management agreement for a further term of twelve (12) months at a mutually agreed management fee.'

- (4) 'Monthly management fee of HK\$60,000 will be charged by [Company A]. Invoice for the monthly management fee will be issued in the first week of each calendar month and it is due for payment upon receipt by [Company B] or its authorised officer.'
- (5) 'Upon termination or expiration of the Contract, [Company B] will also pay to [Company A], a termination fee of not less than 10% of the total management fee changed throughout the period of this Project.'
- (6) 'Since it is not a contract of employment, the Company is not responsible to contribute any sum of Mandatory Provident Fund or to provide any other benefit to [Company A] or the assigned Consultant similar to those provided to the employees of the Group and the Company.'
- (7) 'Should [Mr D] / [Company B] require [Company A] to provide other professional services than the Project mentioned herein, separate arrangements and agreements will be negotiated separately and mutually agreed.'

9. Subsequently, Company A and Company B renewed their agreement by signing on letters titled 'Agreement for management consultation services to be provided by [Company A]' dated 22 February 2003 (the '2003 Agreement'), 8 January 2004 (the '2004 Agreement'), 28 February 2005 (the '2005 Agreement') and 20 March 2006 (the '2006 Agreement').

10. It is pertinent to observe that the terms of the 2003, 2004, 2005 and 2006 Agreements were essentially the same as those contained in the 2002 Agreement, save that each of them covered different term and provided for different management fees as follows:

<u>Agreement</u>	<u>Term</u>	<u>Monthly management fee</u>
2003 Agreement	01-04-2003 – 31-03-2004	\$66,000
2004 Agreement	01-04-2004 – 31-03-2005	\$70,000
2005 Agreement	01-04-2005 – 31-03-2006	\$70,000
2006 Agreement	01-04-2006 – 31-03-2007	\$73,500

11. On divers dates, the Taxpayer filed his Tax Returns – Individuals for the years of assessment of 2002/03 to 2006/07 declaring income deriving from his employment:

<u>Year of assessment</u>	<u>Employer</u>	<u>Position</u>	<u>Income</u>
2001/02	Company X	General Manager	\$385,295
2002/03	Company A	Director	\$185,000

(2020-21) VOLUME 35 INLAND REVENUE BOARD OF REVIEW DECISIONS

<u>Year of assessment</u>	<u>Employer</u>	<u>Position</u>	<u>Income</u>
2003/04	Company A	Director	\$185,000
2004/05	Company A	Director	\$185,000
2005/06	Company A	Director	\$275,000
2006/07	Company A	Director	\$300,000

12. On divers dates, the Taxpayer's Wife filed her Tax Returns – Individuals for the years of assessment of 2002/03 to 2006/07 declaring income deriving from her employment with Company A and some other companies.

13. The Taxpayer and his Wife had both elected joint assessment under Salaries Tax if it would reduce their aggregate Salaries Tax liabilities. On divers dates, the Assessor raised on the Taxpayer the Salaries Tax Assessments based on such income which the Taxpayer declared to have been derived from his employment with Company A.

14. During the years of assessment of 2002/03 to 2006/07, Company A in its Profits Tax Returns and its financial statements declared the following remunerations received from Company B as part of its business revenue:

<u>Year of assessment</u>	<u>Year ended</u>	<u>Basis of fees</u>	<u>Income</u>
2001/02	31-03-2002	Monthly fee \$60,000 x 2	\$120,000
2002/03	31-03-2003	Monthly fee \$60,000 x 12 + 10% of total fees	\$804,000
2003/04	31-03-2004	Monthly fee \$66,000 x 12 + 10% of total fee	\$871,200
2004/05	31-03-2005	Monthly fee of \$70,000 x 12 + 10% total fee	\$924,000
2005/06	31-03-2006	Monthly fee of \$70,000 x 12 + 10% total fees	\$924,000
2006/07	31-03-2007	Monthly fee of 73,500 x 12 + 10% total fee + Fee for additional service of \$100,000	\$1,070,200

15. Enquiries were raised by the Assessor with Company A, the Taxpayer and Company B respectively. Upon reviewing the responses to his enquiries, the Assessor considered that the remuneration received from Company B was, pursuant to section 9A of the Inland Revenue Ordinance (the 'Ordinance'), the Taxpayer's employment income.

16. On this basis, the Assessor raised on the Taxpayer the Additional Salaries Tax Assessment for year of assessment 2001/02 by adding a sum of \$120,000, being 2 months' management fees of \$60,000 each received from Company B for the period between 1 February 2002 and 31 March 2002, as part of the assessable income for that year of assessment.

17. The Taxpayer, through his tax representative, objected to the above Additional Salaries Assessment on the ground that 'the inclusion of the receipt of \$120,000 from [Company] as the salaries income of [the Taxpayer] is incorrect'. In simplest term,

the Taxpayer's representative argued, *inter alia*, that (1) the Taxpayer and his Wife carried out professional services under the name of Company A; (2) the Taxpayer did not enjoy the benefits as an employee of Company B; (3) he did not need to observe the rules and regulations set by Company B for its employees; and (4) he did not need to work for Company on a full time basis.

18. By a letter dated 12 August 2008, the Assessor invited the Taxpayer to withdraw his objection against the 2001/02 Additional Salaries Tax Assessment. In reply, the Taxpayer through his tax representative refused to withdraw his objection and made further points in support of his position that the management fees received from Company B should not be regarded as Taxpayer's employment income.

19. Despite what was submitted by the Taxpayer's representative, the Assessor remained of the opinion that the remuneration received from Company B was, pursuant to section 9A of the Ordinance, the Taxpayer's employment income. On such basis, the Assessor raised on the Taxpayer the Additional Salaries Tax Assessment for year of assessment 2002/03 to 2006/07 by adding all such management fees received from Company B (as set out in paragraph 14 above) as part of the Taxpayer's assessable income in the respective years of assessment.

20. For the purpose of this appeal, the Additional Salaries Tax Assessment for the year of assessment 2001/02 to 2006/07 as set out in paragraphs 16 and 19 above are referred to as the 'Additional Assessments'.

21. The Taxpayer, through his representative, objected to the Additional Assessments on the ground that it was incorrect to include the remunerations from Company B as part of the Taxpayer's salaries income. Thereafter, further enquiries were made by the Assessor with the Taxpayer and Company B, who gave their respective responses to such enquiries. The Assessor rejected the objection and maintained the Additional Assessments.

### **C. Reasons for the Determination**

22. The main issue of the Determination is whether the Taxpayer should be chargeable to Salaries Tax in respect of the income derived from Company B. The relevant section in the Ordinance is section 9A.

23. Section 9A of the Ordinance, so far as material, provides that:

*'(1) Where a person ("relevant person") carrying on (or deemed under this Ordinance to be carrying on) a trade, profession or business, or prescribed activity, has entered into an agreement ... under which any remuneration for any services carried out under the agreement ... by an individual ("relevant individual") for the relevant person or any other person is paid or credited ... to –*

*(a) a corporation controlled by –*

- (i) *the relevant individual;*
- (ii) *an associate or associates of the relevant individual; or*
- (iii) *the relevant individual together with an associate or associates of the relevant individual;*

...

*then, subject to subsections (3) and (4), ...*

- (i) *the relevant individual shall be treated as having an employment of profit with the relevant person ...*
- (ii) *the relevant individual shall be treated as an employee of the relevant person ...; and*
- (iii) *any such remuneration shall be treated as being ... income derived by the relevant individual from an employment of profit with the relevant person ...*

...

(3) *Paragraphs (i), (ii) and (iii) of subsection (1) shall not apply where –*

- (a) *neither the agreement referred to in that subsection nor any related undertaking (and whether or not the agreement refers to that undertaking) provides for any remuneration for any of those services to include or to be the provision of annual leave, passage allowance, sick leave, pension entitlements, medical payments or accommodation, or any similar benefit, or any benefit (including money) in lieu thereof;*
- (b) *if the agreement referred to in that subsection or any related undertaking (and whether or not the agreement refers to that undertaking) requires any of the services referred to in that subsection to be carried out personally by the relevant individual, the relevant individual carries out the same or similar services –*
  - (i) *for persons other than any person for whom those first-mentioned services are carried out under that agreement; and*
  - (ii) *during the term of that agreement or undertaking, as the case may be;*



- (c) *the performance by the relevant individual of any of those services is not subject to any control or supervision –*
    - (i) *which may be commonly exercised by an employer in relation to the performance of his employee’s duties; and*
    - (ii) *by any person (including the relevant person) other than the corporation or trustee concerned referred to in subsection (1)(a), (b) or (c);*
  - (d) *the remuneration referred to in that subsection is not paid or credited periodically and calculated on a basis commonly used in relation to the payment or crediting and calculation of remuneration under a contract of employment;*
  - (e) *the relevant person does not have the right to cause any of those services to cease to be carried out in a manner, or for a reason, commonly provided for in relation to the dismissal of an employee under a contract of employment; and*
  - (f) *the relevant individual is not held out to the public to be an officer or employee of the relevant person.*
- (4) *Paragraphs (i), (ii) and (iii) of subsection (1) shall not apply where the relevant individual establishes to the satisfaction of the Commissioner that at all relevant times the carrying out of the services referred to in that subsection was not in substance the holding by him of an office or employment of profit with the relevant person.*

...’

24. Before considering the specific provision of section 9A of the Ordinance, the Commissioner, as a preliminary matter, held that he would accord both the 2002 Proposal and the 2002 Agreement with the same weight in ascertaining the contractual relationship between Company A and Company B under the engagement.

25. The Commissioner took the view that all the conditions specified in section 9A(1) of the Ordinance have been satisfied. Thus, subject to sections 9A(3) and (4), the Taxpayer is required to be treated as being employed by Company B and those remunerations received from Company B would be regarded as the Taxpayer’s employment income and, hence chargeable to Salaries Tax.

26. The Commissioner then moved on to consider section 9A(3) of the Ordinance. The Commissioner considered each of the 6 criteria set out under section

9A(3) and found that, with the exception of the criteria set out in section 9A(3)(a), the specific criteria in section 9A(3) were not satisfied. Accordingly, the Taxpayer would be required to pay Salaries Tax in respect of the remunerations paid by Company B under his case falls within Section 9A(4).

27. As to section 9A(4), the Taxpayer was required to satisfy the Commissioner that at all relevant time, the carrying out of the services to Company B was not in substance the holding by the Taxpayer of an office or employment of profit with Company B. The Commissioner then directed himself to consider the application of the ‘control test’, ‘integration test’ and ‘economic reality test’.

28. As to the ‘control test’, the Commissioner acknowledged that it might be true that Company B did not exercise much control as to how the Taxpayer discharged his duties, this could not be viewed as usual in an employment relationship bearing in mind the Taxpayer’s expertise and duties.

29. As to the ‘integration test’, the Commissioner took into consideration that (a) Company B provided the Taxpayer with a name card which indicated that the Taxpayer was part of the organisation of Company B, (b) Company A only purchased small amount fixed assets such that it could be presumed that the equipment used by the Taxpayer for the discharge of his duties was provided by Company B, (c) the Taxpayer did not hire any helper to assist him discharging his duties.

30. As to the ‘economic reality test’, the Commissioner noted that the Taxpayer was reimbursed of all outgoings and expenses in connection with the performance of his duties to Company B, and that there was no evidence of the Taxpayer assuming any financial risks in the performance of such duties.

31. For the above reasons, the Commissioner took the view that the true relationship between the Taxpayer and Company B was in substance one of employment. Accordingly, section 9A(4) is inapplicable and the remuneration paid by Company B to Company A should be treated as the Taxpayer’s employment income chargeable to Salaries Tax.

32. Alternatively, the Commissioner also opined that the interposition of Company A between the Taxpayer and Company B was a transaction caught by section 61 of the Ordinance, which empowers an assessor to disregard any transaction which is ‘artificial or fictitious or is not in fact given effect to’. In this regard, the Commissioner placed emphasis on the fact that much of the deductions claimed by Company A were private or domestic expenses of the Taxpayer and his Wife which would not have been allowed had such deductions been claimed under the regime of Salaries Tax. Thus, the Commissioner took the view that the transaction was ‘artificial’ in that Company A was interposed for the receipt of income from Company B for tax avoidance purpose.

#### **D. The Taxpayer’s Appeal**

33. In this appeal, the Taxpayer challenged the Determination that the

remunerations paid by Company B were chargeable to Salaries Tax under section 9A(1) of the Ordinance. The Taxpayer argued that section 9A(1) does not apply because (a) all the 6 criteria in section 9A(3) had been fulfilled, and (b) further and in any event, the carrying out of the services was not in substance the holding by the Taxpayer of an office or employment of profit with Company B.

34. Further or in the alternative, as to the Commissioner's reliance on section 61 of the Ordinance, the Taxpayer argued that the section does not apply since the transaction in question was neither artificial nor fictitious.

35. For the purpose of this appeal, each of the Taxpayer and his Wife had submitted a witness statement<sup>2</sup> explaining their personal background, the business of Company A and their working relationship with Company B. The relevant contents of these witness statements will be referred to in the discussions of the issues below.

## **E. Discussions**

### ***E1. Section 9(4)***

36. The main thrust of the Taxpayer's challenge relates to the Commissioner's finding that he was not satisfied that the carrying out of the services was not in substance the holding of an 'office' or 'employment of profit' within the meaning of section 9A(4) of the Ordinance.

37. In the Determination, the Commissioner took the view that the relationship between the Taxpayer and Company B was in substance one of 'employment'. At the hearing, this Board invited the parties to make submission on the meaning and effect 'office', which did not form part of the basis of the Commissioner's ruling, in section 9A(4) of the Ordinance.

38. Mr Co, Counsel for the Taxpayer, referred this Board to the decision of the House of Lord in Edwards v Clinch [1982] AC 845 in which Lord Wilberforce (at 860E) held that office, as a starting point, connoted something '*which was a subsisting, permanent, substantive position, which had an existence independent of the person who filled it, and which went on was filled in succession by successive holders*'. Although neither 'permanence' nor 'continuity' was a necessary requirement for an 'office' (at 861C), it must connote '*a post to which a person can be appointed, which he can be vacated and to which a successor can be appointed*' (at 861D).

39. On that basis, Mr Co submitted that the Taxpayer could not be said to be holding an 'office' in Company B since there had not been any position of 'consultant' within the structure of Company B.

40. Ms Chan, Government Counsel for the Commissioner, also accepted that

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<sup>2</sup> In case of the Wife, her witness statement was amended to correct a minor typographical error in her original witness statement.

the Taxpayer could not be said to be holding an ‘office’ since the Taxpayer joined Company B for the specific task of getting it listed, and that no one succeeded the position once the parties agreed in late 2006 or early 2007 that the plan for listing was aborted.

41. In view of the parties’ submissions, this Board is satisfied that it does not need to be concerned about the question whether the Taxpayer was in substance holding an ‘office’ in Company B within the meaning of section 9A(4). Hence, the question which this Board needs to consider is whether the carrying out of the services by the Taxpayer was in substance an ‘employment’.

### ***The Applicable Test***

42. As to whether the Taxpayer was in substance holding an ‘employment of profit’ under section 9A(4) of the Ordinance, Mr Co draw the Board’s attention to the decision of the Court of Final Appeal in Poon Chun Nam v Yim Siu Cheung (2007) 10 HKCFAR 156. In that decision, the Court of Final Appeal was called upon to decide whether a person was an employee or an independent contractor for the purpose of an employee’s compensation claim.

43. The Court of Final Appeal (at paragraph 17) endorsed test laid down by Cooke J in Market Investigations Ltd v Minister of Social Security [1969] 2 QB 173, which was approved by the Privy Council in Lee Ting Sang v Cheung Chi Keung [1990] 1 HKLR 764, that:

*‘... the fundamental test to be applied is this: “Is the person who has engaged himself to perform these services performing them as a person in business on his own account?” If the answer to that question is “yes”, then the contract is a contract for services. If the answer is “no,” then the contract is a contract of service. No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of the considerations which are relevant in determining that question, nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases. The most that can be said is that control will no doubt always have to be considered, although it can no longer be regarded as the sole determining factor; and that factors which may be of importance are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk he takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task.’ (emphasis added)*

44. The Court of Final Appeal stressed (at paragraph 18) that:

*‘The modern approach to the question whether one person is another’s employee is therefore to **examine all the features** of their relationship against the background of the indicia developed in the abovementioned*

*case-law with a view to deciding whether, as a matter of overall impression, the relationship is one of employment, bearing in mind the purpose for which the question is asked. It involves a **nuanced and not a mechanical approach.***’ (emphasis added)

45. Ms Chan did not seek to dispute the above principles. In fact, in the Board of Review Decision D13/06, (2006-07) IRBRD, vol 21, 341 referred to by the Commissioner in the Determination, reference is also made to the same test approved by the Privy Council in Lee Ting Sang (supra) and endorsed by the Court of Final Appeal in Poon Chun Nam (supra).

***The contractual document(s) governing the parties’ relationship***

46. In the Determination, the Commissioner began his analysis by holding that the same weight should be attached to the 2002 Proposal and the 2002 Agreement in ascertaining the contractual relationship between the parties. On behalf of the Taxpayer, Mr Co submitted that the Commissioner’s approach was wrong since, on the evidence, the 2002 Agreement was used to supersede the 2002 Proposal, and that the parties’ contractual relationship was therefore governed by the 2002 Agreement.

47. In his witness statement, the Taxpayer explained the genesis of the 2002 Proposal and the 2002 Agreement. In simplest terms, according to the Taxpayer, the 2002 Proposal was drafted and signed in a rush. After securing the signing of the 2002 Proposal, the Taxpayer reviewed its contents and found out that it did not reflect the intended relationship. The Taxpayer, therefore, prepared the 2002 Agreement and asked Mr D to sign the 2002 Agreement to replace the 2002 Proposal.

48. This Board has little reason to doubt the account given by the Taxpayer since every time when the parties renewed their agreement, the parties would sign on such agreements (i.e. 2003, 2004, 2005 and 2006 Agreements) which had contents almost exactly identical to the 2002 Agreement. Had the parties intended that their relationship should be governed by those terms contained in the 2002 Proposal, there would have been no reason for them to adopt those terms contained in the 2002 Agreement when it came to the renewal of their contractual relationship in the following years.

49. In the Determination, the Commissioner placed significant weight to the fact that the word ‘Proposal’ was referred to in the invoices issued by Company A for the monthly management fee. In his Witness Statement, the Taxpayer explained that it was a clerical mistake. According to the Taxpayer, at the time when he caused the first invoice dated 4 February 2002 to be issued, it was issued before the signing of the 2002 Agreement. Thus, reference was made to the word ‘Proposal’ in that first invoice. Thereafter, he simply copied and paste the word in the subsequent invoices issued in the name of Company A.

50. This Board has no reason to doubt the account given by the Taxpayer since in all invoices issued by Company A under the renewed contracts, the word ‘Proposal’ was still used even though the renewed contracts were stated to be ‘Agreement’ (i.e. 2003, 2004,

2005 and 2006 Agreements) and there was no ‘Proposal’ bearing those dates set out in such invoices.

51. Furthermore, the response from Company B contained in a letter dated 25 March 2013 also confirms the account given by the Taxpayer as to why the 2002 Agreement was signed after the signing of the 2002 Proposal, and Company B’s understanding that the terms contained in the 2002 Agreement superseded those in the 2002 Proposal.

52. For the above reasons, this Board takes the view that the correct analysis is that the 2002, 2003, 2004, 2005 and 2006 Agreements (collectively, the ‘Agreements’) constituted the legal documents governing the parties’ contractual relationship.

53. That said, as previous pointed by this Board in D13/06 (supra) at paragraphs 29 & 106, *‘the intended relationship of the parties is of relevance, but it is certainly not a decisive point... the determination under section 9A(3) and 9A(4) is to ascertain the substance or the true nature of their relationship and for that purpose what was intended by the parties or what label they put on their relationship cannot be decisive’*. Thus, it is necessary for this Board to look beyond the terms of the Agreement and to gauge the true nature of the parties’ relationship.

### ***The Taxpayer’s Evidence***

54. In his Witness Statement, the Taxpayer stated, *inter alia*, that:

- (1) He at the material time was a chartered secretary, certified public account and management consultant; whereas his Wife was also a chartered secretary and a professional in human resources management.
- (2) In 1990, the Taxpayer and his Wife decided to begin their own business and incorporated Company A for such purpose.
- (3) Company A focused on the businesses of personal agency and consultancy and had its initial office at District F. The Taxpayer focused on the consultancy business whereas his Wife focused on the personal agency business. Company A was always ready and willing to take on more than one clients at any given time.
- (4) In 1997 to 1998, when Hong Kong was hit hard by Asian financial crisis, the business of Company A declined and the Taxpayer took up some employments. During that time, Company A continued to look for business opportunities, but there was none.
- (5) Around late 2000 and early 2001, the Taxpayer was told by a friend that Company B was looking for a financial controller. Knowing that Company B was Chinese family business, the Taxpayer told his friend that he had no intention to work for Company B because of his

bad experience of working in a Chinese family business. That said, he did meet Mr D with his friend.

- (6) About a year or two later, Mr D invited the Taxpayer to a dinner in which Mr D said that he was planning to make arrangements for Company B to be listed and would like to employ management experts to take care of Company B's operations. In responses, the Taxpayer said that he did not want to work for anyone and was only prepared to assist on the basis of offering consultancy services under Company A; whilst he would be the one who would principally be responsible for giving advice, there might be other consultants under his supervision to take care of the project.
- (7) Later, Mr D informed the Taxpayer that Company B was agreeable to his proposed arrangement. The Taxpayer expressly told Mr D that there was no need to make MPF contributions as Company B would not be the employer, and that there was also no need for Company B to take out any employer's insurance. Further, the Taxpayer would only give advices, but would not execute any decision of Company B.
- (8) Thereafter, the Taxpayer came up with a draft Proposal to secure the business. Later, as he noted that the terms of the 2002 Proposal signed by the parties did not really reflect what was intended, the Taxpayer prepared the 2002 Agreement for the parties to sign.
- (9) The Taxpayer then described his mode of operation at Company B:
  - (a) Depending on whether Mr D was in town, the number of days he spent at Company B's office varied from 20 days or more a month to 2 to 3 days a month only.
  - (b) Company A had a notebook computer and a mobile phone for him, though he sometimes used Company B's computer and telephone if it was more convenient. He would also use Company B's fax machine and photocopier.
  - (c) Apart from asking Company B's staff to get some documents for him, the Taxpayer had no authority to ask Company B's staff to assist. For administrative support, he would turn to his Wife for assistance, which included preparation of documents, booking of transportation, paying of bills, application for visa, etc.
  - (d) In order to prepare for the listing, the Taxpayer advised Mr D that Company B should first recover the embezzled money and inventory from Mr D's brother-in-law. Thus, the Taxpayer

had to assist and advise Company B in bringing legal proceedings in the PRC. To facilitate his works, Mr D printed some Company B's name cards with the Taxpayer's name on them. Despite having such name cards, Company B did not include the Taxpayer in their management structure its company profile distributed to other people, including its bankers.

- (10) At the same time, whilst Company A was engaged by Company B under the Agreements, Company A's other businesses remained in operation. His Wife continued to run, and he continued to assist in, the personal agency business. The business, however, continued to dwindle and there was no further business in around 2004.
- (11) However, Company A continued to look for business opportunities. For instance, Company A had a few one-off engagements by Company B and its related companies on property investment advice; further, Company A also sought to explore business opportunities with companies which had no connection with Company B or its owners.

55. The Taxpayer's Wife also put in a witness statement. Apart from the fact that she could not speak on matters concerning the Taxpayer's dealings with Mr D and Company B, her witness statement essentially corroborates with what was said in the Taxpayer's witness statement.

### ***The Parties' Submissions***

56. On the basis of the evidence presented before this Board, Mr Co on behalf of the Taxpayer placed emphasis on the following matters in support of his argument that the parties' relationship was in substance *not* an employment:

- (1) The Taxpayer was engaged for the narrow purpose of assisting Company B to obtain a listing status. Whilst the Taxpayer was also asked to assist in the proceedings seeking recovery of the embezzled funds and inventory, this was part and parcel of the preparation for the listing application.
- (2) There was little control as to how the Taxpayer perform his services to Company B, and he was not required to attend the office of Company B on a regular basis;
- (3) The Taxpayer enjoyed no employment benefits, such as statutory holidays or MPF contributions;
- (4) The Taxpayer could not direct any staff members of Company B to work for him and had to resort to his Wife for administrative support. He in fact was not named as part of the management team in Company



B's company profile;

- (5) In addition to the Agreements, Company A also performed and separately charged for other advisory works rendered to Company B's associated companies.
- (6) Whilst performing services to Company B and its related companies, Company A continued to look for engagements by other companies.

57. Whilst Ms Chan spent some time to cross-examine the witnesses, this Board does not understand her to be mounting a wholesale challenge of the credibility of the evidence given by the Taxpayer and his Wife. In fact, Ms Chan did not ask this Board to reject their evidence in her written closing submissions. Instead, Ms Chan's submission on behalf of the Commissioner relied on the following matters to argue that there was in substance an employment relationship:

- (1) Adopting the reasoning of the Commissioner, this Board should place weight on the 2002 Proposal, equal to that of the 2002 Agreement, in ascertaining the contractual relationship of the parties;
- (2) The way in which Company A was remunerated (i.e. monthly payment plus *ex gratia* payment upon expiration of contract) is typical of an employment relationship;
- (3) If one compares the terms of the 2002 Proposal and the Agreements on the one hand and the service contract which Company A proposed to enter into with another company, one would notice that the terms of the former were more akin to an employment contract. For example, in the proposed service contract with Company G, one would note that Company A was offering to provide a feasibility analysis to Company G with 50% payment to be made up-front and the other 50% to be paid after submission of the report.
- (4) The Taxpayer not only was given Company B's name cards bearing his name on them, he was also given an email account with Company B for business communication purposes. These show that Company B regarded the Taxpayer as its employee.
- (5) The fact that the Appellant was engaged on the basis of his expertise does not assist. An employer can employ a person by reason of his professional qualification. Since the Appellant was engaged on such basis, the fact that there was little control over his works and that he did not regularly station at Company B's office also does not show that he was not an employee.
- (6) The Taxpayer did use the equipment provided by Company B in carrying out his work, and did not assume any financial risks in

rendering his services. At the same time, the Taxpayer did not profit from sound management in the performance of his services.

*Analysis*

58. As a starting point, this Board does not consider that this case turns on the credibility of the evidence given by the Taxpayer and his Wife. Instead, the case turns on whether, as a matter of overall impression, the relationship was in substance one of employment after examining all the features of the parties' relationship.

59. In fact, as pointed out in paragraph 57 above, Ms Chan did not seek to mount a wholesale challenge of the credibility of the evidence given by the Taxpayer and his Wife. This Board takes the view that they are honest witnesses and accepts such evidence given by the Taxpayer and his Wife in their respective witness statements as supplemented by their oral evidence.

60. On the question as to which document(s) governed the parties' contractual relationship, for the reasons explained in paragraphs 46 to 53 above, this Board finds that the Agreements were intended by the parties to be the legal documents setting out their contractual relationship.

61. Under the Agreements, Company A, headed by its 'consultant', was required to provide pre-floatation consultation services to Company B for a limited period of time. Notwithstanding that the Taxpayer was not specifically named in the Agreements, the Taxpayer accepted in his witness statement that he would principally be responsible for giving advice. Viewed in its context, the 'consultant' referred to in the Agreements must refer to the Taxpayer.

62. That said, on strict contractual terms, the services were to be rendered by Company A, not by any specific individual(s). Further, according to the Taxpayer, he told Mr D that there might be other consultants under his supervision to take care of the project. In this regard, it is pertinent to note that Company B also claimed in their letter dated 25 March 2013 that it never occurred to them whether or not they were engaging the Taxpayer's personal services as such, and that their primary concern was simply whether they could have the benefit of the services which they needed at the time. In the circumstances, it seems fair to say that whilst the parties expected that services to be rendered under the Agreements would be principally performed by the Taxpayer personally, the Agreements were not for personal services.

63. As to the actual performance of the services, the evidence (which this Board accepts) is that the Taxpayer was under little control and was not required to attend Company B's office regularly. Further, the Taxpayer had no authority to direct Company B's employees to provide him with administrative support; instead, the Taxpayer had to rely on his Wife to perform such supportive works. Furthermore, the Taxpayer would not enjoy any benefits (e.g. statutory leave and MPF contributions) to which any employee would be entitled. Thus, even though the Taxpayer was expected to be principally responsible for performing the services under the Agreements, it would not be entirely apt to describe the

relationship as one of employment in substance.

64. As to the payments of remuneration by way of monthly payments, this Board does not consider this to be a factor indicative of the true nature of the parties' relationship. Depending on the nature and scope of the services to be rendered, it is not difficult to imagine that commercial parties agree to remunerate such services rendered by external consultants by way of monthly payments. For the same reason, this Board also does not consider it helpful to compare the terms of the Agreements with those contained in the contract proposed to be entered into between Company A and Company G, which only required Company A to provide a one-off service of rendering a feasibility study.

65. In this regard, it is of some significance to note that throughout the course of the Agreements, Company A had a few one-off engagements by Company B as well as its related companies. Normally, all services rendered by an employee would be covered by his monthly salaries. If the parties' relationship was in substance one of employment, it would be difficult to envisage why in addition to the agreed monthly payments under the Agreements, extra consultation fees would be paid to Company A in respect of such services rendered by the Taxpayer in the name of Company A, particularly those services rendered to Company B.

66. In addition to providing and separately charging for other services rendered to Company B and its related companies, the evidence also shows that during the terms of the Agreements, the Taxpayer and his Wife in the name of Company A looked for other business opportunities, e.g. providing listing feasibility study to Company G. At the same time, there is no evidence of Company B prohibiting Company A and/or the Taxpayer to provide services to other companies during the terms of the Agreements. In D13/06 (supra), this Board (at paragraph 106) cited with approval the Australian decision of Abdalla v Viewdaze Party Ltd 53 ATR 30, in which it was observed, amongst other things, that *'the right to the exclusive services of the person is characteristic of the employment relationship. On the other hand, if the individual also works for others (or the genuine and practical entitlement to do so) then this suggests independent contract'*. In light of the state of evidence, this Board finds Company A and the Taxpayer at the material time had genuine and practical entitlement to work for others and such finding is indicative of the existence of a relationship of independent contractor.

67. The Commissioner placed emphasis on Company B's name cards bearing the name of the Taxpayer. In this appeal, it was further pointed out that the Taxpayer was given an email account with Company B for business communication purposes. The point is that these matters show that the Taxpayer effectively worked or was held out to the outsiders as an employee of Company B. However, the weight to be given depend on the context. As explained by the Taxpayer, in order to enable the Taxpayer to assist in the embezzlement proceedings, things had to be done to clothe the Taxpayer with authority to represent Company B. Further, whilst the Taxpayer was given name cards and email account belonging to Company B, he was *not* named as part of Company B's management team in Company B's Company Profile 2005. Furthermore, as pointed out in preceding paragraph, Company A and the Taxpayer at the material time had genuine and practical entitlement to work for others. In all the circumstances, this Board considers that not much

weight can be given to these matters as an indicator of an employment relationship.

68. Regarding the factor of equipment and tools, bearing in mind that the services in question were consultancy services, not much equipment and tools would be required for the provision of such services. Thus, this factor is of little significance in the determination of the true nature of the parties' relationship.

69. Regarding the factor of financial risks, this Board also takes the view that it is a factor of little significance in the present case. It can be said loosely in almost every case involving provision of professional services that the consultant charging an agreed consultation fees assumes no financial risk. This, however, cannot be correct as a matter of proper analysis. By committing his time and efforts to provide services to a client, the consultant's ability to profit for other business opportunities would be restricted. Equally, it is not analytically correct to say that a consultant would not profit from sound management simply because he charges an agreed consultation fees, whether on a monthly basis or by way of a lump sum. This is because the quality of services rendered by the consultant may affect his ability to be awarded with further contracts or may expose him to potential liability. In the opinion of this Board, the factor of financial risks is not a helpful indicator of the parties' true relationship in the context of the present case.

70. Having regard to all the circumstances of the present case, and applying the test approved by the Court of Final Appeal in Poon Chun Nam (supra), this Board finds that the carrying out of the services in question was not in substance an employment with Company B. By virtue of section 9A(4) of the Ordinance, the Taxpayer should not be chargeable to Salaries Tax under section 9A(1). Accordingly, this Board is satisfied that the Taxpayer has duly discharged his onus of proving that the raising of the Additional Assessments was incorrect.

**E2. Section 9(3)**

71. In D13/06 (supra), this Board observed (at paragraph 13) that:

*'It cannot be intended that the application of any of the criteria under section 9A(3) would individually produce the correct result in the determination of the true nature of the relationship in question. That is the reason for the prescription of six criteria. Further, even where a taxpayer cannot satisfy all the six criteria, he can still fall back upon section 9A(4) to get out of section 9A(1).'* (emphasis added)

72. Accordingly, in view of the conclusion of this Board that section 9A(1) of the Ordinance is inapplicable in the present case by virtue of section 9A(4), it would not be necessary for this Board to consider and rule on those six factors set out under section 9A(3) of the Ordinance.

**E3. Section 61**

73. Section 61 of the Ordinance provides that:

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

74. In this appeal, as clarified by Ms Chan in her opening and closing submissions, the Commissioner does not seek to suggest that the transaction was ‘fictitious’; rather, the Commissioner’s case is that the interposition of Company A between the Appellant and Company B is commercially unrealistic and ‘artificial’ in that there was no genuine commercial reason for interposing Company A apart from enabling the Taxpayer to claim his personal and private expenses as deductions under Company A.

75. References were made to various authorities on the meaning of the ‘artificial’ in this context: Seramco Limited Superannuation Fund Trustees v Income Tax Commissioner [1997] AC 287 (at 298A-D); Commissioner of Taxpayer Audit and Assessment v Cigarette Co of Jamaica Ltd (in liquidation) [2012] 1 WLR 1794 (at paragraphs 21-23); Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773 (at paragraphs 39-42). Essentially, the courts held that whether a transaction should be regarded as ‘artificial’ depends on the specific circumstances of each case, and an ‘artificial’ transaction is one in respect of which an informed bystander may say ‘*this simply would not happen in the real world*’ or ‘*there is simply no commercial sense in the transaction*’.

76. In the present case, this Board does not consider that the interposition of Company A can be said to be ‘artificial’. The transaction served at least two commercial purposes: First, Company B would not be required to provide the Taxpayer or any other consultant(s) from Company A with such employment benefits to which an employee would be entitled; second, the Taxpayer would not be required to serve Company B exclusively as an employee and could explore other business opportunities, whether in the name of Company A or otherwise.

77. Further, this Board accepts Mr Co’s submissions that if this Board comes to the conclusion that the parties’ relationship was *not* in substance an employment relationship, it would be absurd to characterise the transaction under the Agreements as ‘artificial’ within the meaning of section 61. In this regard, it is plain from Ms Chan’s submission that the Commissioner’s argument on section 61 is rested on the assumption that the relationship was in substance one of employment, such that the interposition of Company A served no commercial purpose other than to reduce the overall tax liabilities of Company A and the Taxpayer. In view of the finding of this Board that the relationship was in substance not an employment, the Commissioner’s argument on section 61 also falls away.

(2020-21) VOLUME 35 INLAND REVENUE BOARD OF REVIEW DECISIONS

78. Accordingly, this Board is satisfied that the Commissioner erred in raising the Additional Assessments based on section 61 of the Ordinance.

**F. Dispositions**

79. For the above reasons, this Board finds that the remunerations paid by Company B are not chargeable to Salaries Tax and the Taxpayer's appeal is allowed.

80. This Board understands that there was also another Additional Salaries Tax Assessment for the year of assessment 2003/04 raised against the Taxpayer which related to home loan interest deduction (the 'Second Additional Assessment'). Although the issue of home loan interest deduction is not a subject matter of this appeal, since computation of the tax liabilities under the Second Additional Assessment was also based on the Assessor's ruling that the remunerations paid by Company B were chargeable to Salaries Tax, this Board asked Ms Chan to provide a table setting out the effect on the Additional Assessments and the Second Additional Assessment if this Board were to allow the appeal.

81. Based on the said table provided by Ms Chan, this Board orders that an additional assessment in the sum of HK\$2,781 be raised against the Taxpayer in substitution of those contained in the Additional Assessments and the Second Assessment, which are hereby set aside and annulled.