

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. BR 64/76

*Board of Review:*

Chan Ying-hung, *Chairman*, D. Barrett, R. S. Huthart & Peter P. L. Li, *Members*.

**20th January 1978.**

Salaries tax – taxpayer appointed general manager of Hong Kong company by affiliated foreign company – contract of employment enforceable in foreign country – performance of duties in and outside Hong Kong – salary paid by Hong Kong company but reimbursed by foreign company – whether situs of employment in Hong Kong.

The taxpayer was director and general manager of a Hong Kong company which acted as purchasing agent for two affiliated companies in Europe. The taxpayer had previously worked in one of the European companies and was then made a director of the Hong Kong company. Prior to his coming to Hong Kong the taxpayer entered into a contract of employment with the European companies under which he was appointed manager at a salary. The contract which was enforceable in Germany set out the range of work and general duties that the taxpayer had to perform for the Hong Kong and European companies. The taxpayer received no fee as a director and his salary as general manager was paid by the Hong Kong company but was recovered from one of the European companies. In addition to performing administrative duties for the Hong Kong company and representing the interests of the European companies in Hong Kong, the taxpayer also performed duties for the European companies outside Hong Kong.

The Commissioner took the view that the situs of the taxpayer's employment was within Hong Kong and that the remuneration he received was chargeable to salaries tax under section 8(1)(a) of the Inland Revenue Ordinance. The taxpayer appealed on the grounds that his income derived in substance from an employment that did not have a source in Hong Kong and that his tax liability was restricted to that portion of his remuneration which related to services performed by him in Hong Kong. On appeal.

**Decision:** Appeal disallowed. Assessment confirmed.

D. Flux of Peat, Marwick, Mitchell & Co. for the taxpayer.  
Benjamin Shih for the Commissioner of Inland Revenue.

*Reasons:*

1. The Taxpayer was the General Manager of a company (hereinafter referred to as "the Hong Kong Company") from 1st April 1973 to 31st December 1975 and this appeal relates

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to his salary tax assessments for the years of assessment 1973/74, 1974/75 and 1975/76. The Hong Kong Company is a private company incorporated in Hong Kong on 18th November 1966. It carries on business in Hong Kong as garment wholesalers. In addition it acts as purchasing agents in the Far East for two affiliated companies in Europe, hereinafter respectively referred to as “the German Company” and “the Dutch Company” and collectively as “the European Companies”. The word “Group” whenever used means the European Companies and the Hong Kong Company. As such purchasing agents as aforesaid, the Hong Kong Company receives commissions from garment manufacturers and fees from the European Companies at the rate of 3% on all orders placed by them through the Hong Kong Company.

2. The Taxpayer had worked in the German Company for about 5 years prior to 1969. In July 1969 he came to Hong Kong and assumed the post of “Sales and Shipping Department Manager” of the Hong Kong Company. He held that position until 31st August 1971 when he returned to Germany.

3. On 31st December 1972 he was elected a Director of the Hong Kong Company, an office which he still holds. He came to Hong Kong again in 1973 and this time he occupied the post of General Manager of the Hong Kong Company from 1st April 1973 to 31st December 1975.

4. On 1st March 1973 a contract in the German language was entered into between the European Companies of the one part and the Taxpayer of the other. It purports to be a service contract whereby the Taxpayer was appointed by the European Companies as Manager at a gross salary of DM4,500.00 or HK\$9,000.00. This contract contains, *inter alia*, the following terms:-

*“Range of Work:* The Taxpayer’s area of work covers the whole field of activities in the organising of the Far East business outlets which are controlled and directed by the Hong Kong Company for the German Company and the Dutch Company with the exception of purely technical textile operations.

*General Duties:* The Taxpayer will devote his whole working power to the Company which employs him, he will to the best of his abilities protect the interests and reputation of the European Companies and follow business regulations.

*Jurisdiction:* Hamburg”.

5. It seems clear to us that the expression “the Company which employ him” refers to the Hong Kong Company. If there is any doubt at all about this, we have the fact that both in the Employer’s returns and in the Taxpayer’s returns for the years of assessment under appeal, the “employer” of the Taxpayer is stated to be the Hong Kong Company.

6. The Taxpayer objected to all the Salaries Tax assessments raised against him on the ground that he was entitled to claim a deduction of a proportion of his Salaries Tax for the

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number of days he was out of Hong Kong, i.e. 104 days, 105 days and 70 <sup>1</sup>/<sub>2</sub> days during the 3 years of assessment respectively.

7. In his objections the Taxpayer relied on his contract of employment partly quoted above and an unsigned agreement between the German Company of the one part and the Hong Kong Company of the other part dated 21st September 1973. Under this unsigned agreement, it was agreed that the Hong Kong Company was to build up a Sales Department on behalf of the German Company in the Far East. The agreement refers to the Department as the Sales Department of the Hong Kong Company and its principal functions were to meet purchasing groups and individual buyers from Europe travelling to the Far East and to take orders from them based on the German Company's instructions and in its name only. The German Company would refund to the Hong Kong Company expenses incurred by its Sales Department such as salaries, rent, administration, entertaining and travelling expenses. The agreement is essentially one relating to sales for the German Company. A number of monthly statements of such expenses rendered by the Hong Kong Company to the German Company as well as remittance advices by the German Company and bank credit notes were produced. According to these documents, the Taxpayer's salaries were paid by the Hong Kong Company and recovered by them from the German Company.

8. The Taxpayer received no remuneration as a Director. As such his duties were to attend Directors Meetings and to sign balance sheets. Apart from these perfunctory duties, however, the Taxpayer also had "to look after the Company on the administrative side". These duties were laid down at a special Board Meeting held in Hamburg. As indicated above the Taxpayer was made a Director on 31st December 1972 and he was in Germany from 31st August 1971 until 1st April 1973 when he assumed office as General Manager. In these circumstances, we do not see how he could have effectively supervised the general administration of the Hong Kong Company when he was a Director resident in Germany. In our opinion, and we so find, the Taxpayer only started to do this when he became General Manager in April 1973 but not before.

9. As to the Taxpayer's duties outside Hong Kong, it was contended by the Taxpayer before the Assessor and we accept as facts that as the Hong Kong Company was the purchasing agents for the European Companies, the Taxpayer has to visit garment manufacturers with whom the European Companies have placed orders and to ensure that such orders are executed properly. As the Taxpayer himself put it to the Assessor, failure to do so would mean the Hong Kong Company would commit a breach of the agency contract and would get less income in the way of inspection fees. As to sales, we have already referred to the unsigned agreement between the Hong Kong Company and the German Company. The output duties of the Taxpayer in this respect include supervising sales, promoting and finding more outlets for the German Company's merchandise as well as settling disputes of overseas claims on their behalf.

10. On these facts, the Commissioner decided that notwithstanding the fact that the Taxpayer had a contract of employment with the European Companies enforceable in Germany and that the remuneration paid him by the Hong Kong Company was recovered from the German

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Company, the situs of his employment was within the Colony and his income was chargeable to Salaries Tax under section 8(1)(a) of the Ordinance. Against this, the Taxpayer has appealed.

11. Shortly before the appeal was due to be heard – to be exact on 3rd September 1977 – Mr. C. a Departmental Manager of the Hong Kong Company, wrote to the European Companies seeking clarification of the Taxpayer's duties in the Far East and his exact status in the Group. The reply received dated 8th September 1977 states that the Taxpayer was sent to Hong Kong because of difficulties experienced by the European Companies in getting supplies from the Far East which they attributed to the lack of expertise and poor service offered by the Hong Kong Company; that when in Hong Kong the Taxpayer represented the interests of the European Companies in negotiating for and ensuring regular supplies of merchandise; that he was paid by his German employer throughout; that the Taxpayer had no managerial responsibility to the Hong Kong Company; and that he was given the title General Manager of the Hong Kong Company so that some substance was given to his position in his dealings with the Group's suppliers in the Far East who were in the habit of dealing with the Hong Kong Company.

12. Mr. D. Flux of Messrs. Peat, Marwick, Mitchell & Co., Chartered Accountants, conducted the appeal on behalf of the Taxpayer.

13. His submission is that for the years in question the income of the Taxpayer derives in substance from an employment that does not have a source in Hong Kong and that his Salaries Tax liability is limited to tax on that portion of his remuneration which relates to services performed by him in Hong Kong.

14. Mr. Flux's arguments have been succinctly summarized by him as follows:-

- (a) The Taxpayer's contract was executed and was enforceable in Germany;
- (b) His remuneration was borne by the European Companies which have no presence in Hong Kong;
- (c) His duties were under the direction and supervision of the European Companies;
- (d) The fruits of his labours were for the benefit of the European Companies;
- (e) The remuneration did not attach to the office of Director nor to the title of General Manager of the Hong Kong Company which position had no substance.

15. Mr. Benjamin Shih, Chief Assessor who appeared for the Commissioner joined issue with Mr. Flux on all points.

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16. In support of his arguments, Mr. Flux relies heavily upon the last minute letter from the European Companies of 8th September 1977 mentioned above. To substantiate the contents of the letter and his arguments, Mr. C. was called as a witness.

17. According to his testimony, the Hong Kong Company now has a General Manager whose salary is paid by the Hong Kong Company. It is not charged to either of the European Companies. Unlike the Taxpayer, he is based in Hamburg and visits Hong Kong and other places in the Far East periodically. The Chairman of the Hong Kong Company and his wife own all the shares in it. The European Companies are not shareholders. Under cross-examination by Mr. Shih, and in answer to questions put by the Board, he reveals that prior to 1973 the duties later performed by the Taxpayer had been carried out by a Director named H. Poor performances under his management led to delay in supplies resulting in cancellation of orders and payment of damages. In consequence, a meeting was held in Hamburg between the German Company and the Dutch Company at which the witness was present. The outcome was Mr. H. was replaced by the Taxpayer. The latter had to see buyers from Europe for the European Companies, settle claims for them and also place with them orders received from European buyers. According to the witness, in reality buyers from Europe were in fact negotiating with the European Companies "via the Hong Kong Company through the taxpayer", the General Manager. The reason why he was not called representative of the European Companies is that buyers from Europe wanted to negotiate with the Hong Kong Company and not with a representative of the European Companies. As to purchases from manufacturers, the Hong Kong Company would place orders for the European Companies as their agents. He was at pains to point out that all decisions relating to orders for sale and purchase placed through the Hong Kong Company could only be made after taking directions from the Chairman of the Hong Kong Company who alone had managerial responsibility for the Hong Kong Company. He conceded, however that the Taxpayer was one of two persons who jointly signed cheques on behalf of the Hong Kong Company. He also signed correspondence and other documents as General Manager of the Hong Kong Company.

18. We are not impressed by the evidence of this one and only witness for the Taxpayer and do not find his explanations as to why the Taxpayer was given the title General Manager of the Hong Kong Company at all convincing. As the Taxpayer was a Director of the Hong Kong Company at all material times, he could have performed his duties equally well, if not better, if he carried out his duties under that title and in that capacity. In our view, he was given the title General Manager not for the sake of giving substance to his status but because his actual duties were those of a General Manager.

19. Dealing now with the arguments of Mr. Flux in the order in which they have been raised:-

- (a) Holding as we do that the Taxpayer was employed by the Hong Kong Company, his employment must be the subject of a contract. There was no written contract between them but there was one signed between the Taxpayer and the European Companies. On the facts before us, we hold that this has been adopted by the Taxpayer and the Hong Kong Company as the contract that governs their

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relationship. We accept Mr. Flux's submission that by express provision this contract is enforceable in Germany but, like the Commissioner, we hold that this is just but one of the many criteria for determining the situs of employment.

- (b) We accept the fact that the remuneration of the Taxpayer was ultimately borne by the European Companies but we reject the contention that the European Companies had no presence in Hong Kong. They carried on business in Hong Kong through their agents headed by a General Manager nominated by them. We also take note of the fact that the Taxpayer received his salary in Hong Kong in Hong Kong Dollars from a Hong Kong company even though it was subsequently recovered from the European Companies.
- (c) Not all the duties of the Taxpayer were under the direction and supervision of the European Companies. According to the evidence before us it was only in respect of orders for sale and purchase that the decision of the Chairman of the Hong Kong Company had to be obtained. In all other matters such as general administration, investigations of overseas markets and promotion of business, the Taxpayer was in complete charge.
- (d) Both the European Companies and the Hong Kong Company benefited from the services of the Taxpayer, and
- (e) In our opinion, the salary received by the Taxpayer was paid to him in return for his services as General Manager of the Hong Kong Company. It was certainly not a position that existed in name only but one that carried with it substantial duties.

20. In conclusion, on the view we take of the facts in this case and considering them in totality, we hold that the whole of the Taxpayer's salaries arose or derived from a source in Hong Kong such source being his employment or post of General Manager of the Hong Kong Company. We also find that his services abroad rendered outside Hong Kong were incidental to such employment or post. In consequence, the appeal is dismissed and the assessments are confirmed.