(2008-09) VOLUME 23 INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D1/08

Salaries tax – source of employment – whether service performed in Hong Kong

Panel: Anna Chow Suk Han (chairman), Emmanuel Kao Chu Chee and Kenneth Graeme Morrison.

Date of hearing: 8 November 2007.
Date of decision: 7 April 2008.

The taxpayer was employed by Company C which was incorporated in Country B and registered as overseas company in Hong Kong. His employment was evidenced by three letters.

The taxpayer contended that his employment was concluded in Country B, his employer was not a Hong Kong resident company, and he conducted most of his work in Country B.

Held:

1. The Board found the taxpayer' s employment was concluded in Hong Kong because the three employment letters, as contemporaneous documents, were prepared by Company C using its address in Hong Kong and were sent to the taxpayer in Hong Kong.

2. The taxpayer' s remuneration was paid to him in Hong Kong and the Hong Kong Branch of Company C filed the taxpayer' s tax returns in Hong Kong. It proved that he was employed by Company C in Hong Kong. Therefore, the Board found his employment Hong Kong sourced.

3. The Board also found the taxpayer performing his work during his visits in Hong Kong.

Appeal dismissed.

Case referred to:

Goepfert (1987) 2 HKTC 210

Taxpayer in person.
Tang Hing Kwan for the Commissioner of Inland Revenue.

Decision:

The appeal

1. Mr A ('the Taxpayer') has objected to the salaries tax assessment for the years of assessment 2003/04 and 2004/05 raised on him.

2. Prior to the determination of the Deputy Commissioner of Inland Revenue of 30 April 2007 ('the Determination'), the Taxpayer in his tax returns for 2003/04 and 2004/05 claimed respectively that his income should be apportioned between the numbers of days he spent within and outside Hong Kong and only those portions which related to the numbers of days he spent within Hong Kong, should be subject to tax. After delivery to him of the Determination, in his ground of appeal, the Taxpayer claimed that he did not render any services at all during his stays in Hong Kong in the said assessment years.

The law

3. Section 8(l) of the Inland Revenue Ordinance ('IRO') is the basic charging section for salaries tax. Section 8(1) provides as follows :

> *'Salaries tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from the following sources –*
>
> *(a) any office or employment of profit; and*
>
> *(b) any pension.'*

4. Section 8(IA)(a) of the IRO creates a liability to tax additional to the basic charge in section 8(1). Section 8(lA)(b) and (c) exclude certain income from the charge to salaries tax. Section 8(IA)(a) (b) and (c) read as follows :

> *'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.'

5. Section 8(1B) further provides :

'In determining whether or not all services are rendered outside Hong Kong for the purposes of subsection (IA) 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.'

6. Section 64(4) provides :

'In the event of the Commissioner failing to agree with any person assessed, who has validly objected to an assessment made upon him, as to the amount at which such person is liable to be assessed, the Commissioner shall, within 1 month after his determination of the objection, transmit in writing to the person objecting to the assessment his determination together with the reasons therefor and a statement of the facts upon which the determination was arrived at, and such person may appeal therefrom to the Board of Review as provided in section 66.'

7. Section 66(1)(a) provides :

> *'Any person (hereinafter referred to as the appellant) who has validly objected to an assessment but with whom the Commissioner in considering the objection has failed to agree may within :-*
>
> *(a) one month after the transmission to him under Section 64(4) of the Commissioner's written determination together with the reasons therefor and the statement of facts; or'*

8. Section 68(4) provides :

> *'The burden of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'*

9. Section 8(1) of the IRO is the basic charging section for salaries tax and section 8(IA)(a) is an extension of section 8(1). Under section 8(1), salaries tax is chargeable in respect of income arising in or derived from Hong Kong from any employment. The basic charge to salaries tax is specifically extended to include all income derived from services rendered in Hong Kong. Liability to salaries tax arises under the extended charge when a taxpayer provides services in Hong Kong even though his employment is not located in Hong Kong. It has been well accepted and also confirmed in the Goepfert case, that in deciding whether income arises in or is derived from Hong Kong from any employment, regard is had to the place where the income really comes to the employee, that is, where the source of income, the employment, is located and in determining the source of employment for salaries tax purposes, the place where the services were performed is irrelevant to the enquiry.

10. Thus, if the source of a taxpayer's employment is located in Hong Kong, his entire income will be subject to salaries tax under section 8(l) of the IRO and no apportionment can be made with reference to the services rendered outside Hong Kong. However, section 8(1A) (b) provides an exemption to tax where a person renders outside Hong Kong all the services in connection with his employment. If the source of a taxpayer's employment is located outside Hong Kong, only such part of his income derived from services rendered in Hong Kong including leave pay attributable to such services, will be subject to salaries tax under Section 8(1A)(a) but no account shall be taken of services rendered in Hong Kong during the taxpayer's visits not exceeding a total of 60 days in the basis period of the year of assessment.

The issue

11. It is our observation from the correspondence exchanged between the Taxpayer and the Revenue prior to issuance of the Determination that the Taxpayer claimed that his contract of employment as subsisting in 2005, was a non-Hong Kong employment and his salaries tax should be apportioned on a time-in and time-out Hong Kong basis. In the Determination, the Deputy

Commissioner took the view that the Taxpayer's employment was Hong Kong sourced and therefore his entire income derived from this employment was chargeable to salaries tax. However, it is unclear whether or not the Taxpayer was maintaining the claim of a non-Hong Kong employment in his appeal. When clarification was sought from the Taxpayer at the hearing on whether or not he confirmed the Revenue's stance that his employment was Hong Kong sourced, his reply was that he was employed by the company in Hong Kong for administration reasons only but the company in Hong Kong was reimbursed all costs by the company in Country B. In view of the imprecision of the Taxpayer's response, in fairness to him we ought also to consider whether or not the Taxpayer's employment during the assessment years in question was Hong Kong sourced. If his employment was Hong Kong sourced, his entire income is chargeable to salaries tax. There will be no apportionment on the time-in and time-out Hong Kong basis. However, if his employment was Hong Kong sourced but he did not render any services in Hong Kong for his employment, his entire income is not chargeable to salaries tax in Hong Kong.

12. Hence, there are two issues for us to decide :

(a) the source of the Taxpayer's employment; and

(b) whether or not the Taxpayer rendered any services in Hong Kong during his stays in Hong Kong in the assessment years in question.

The facts

13. (a) Company C was incorporated in Country B. Its registered office in Country B was at Address D, and was changed to Address E with effect from 1 January 2004. At all relevant times, Company F was a director of Company C.

(b) Company C was registered as overseas company in Hong Kong under Part XI of the Companies Ordinance on 13 October 2000. At all relevant times, Company C was carrying on the business of provision of baggage handling system and other supporting services in Hong Kong through a branch office. The Hong Kong branch office was initially located at Address G ('the First Address') and changed to Address H ('the Second Address') with effect from 1 February 2001.

14. Company F was incorporated in Country I. Company F was formerly known as Company J and was registered as overseas company in Hong Kong under Part XI of the Companies Ordinance on 14 July 1998. Company F changed its name to the present one on 23 April 1999. According to a Notice of Change of Address dated 24 July 2001 filed to the Companies Registry of Hong Kong. Company F maintained a place of business in Hong Kong at the Second Address.

15. By a letter dated 23 November 2000 ('the First Letter'), the Taxpayer was offered and he accepted an employment with Company C (Hong Kong Branch) as a Service Delivery Manager, to work in Hong Kong. His letter of employment included, inter alia, the following terms and conditions :

'1. POSITION : You are appointed as Service Delivery Manager, to work in Hong Kong. General responsibilities include the overall management of this company' s contract with [the organization] for management and operation of [a named System].

2. COMMENCEMENT : Your employment shall commence on 6th January 2001 and terminate on 5th January 2002, at which time there is no further obligation on the part of either party. This is a fixed-term contract.

…

4. WORK HOURS : You will normally be required to work forty five (45) hours each calendar week, based on a five day work week. Details of your work schedule will be advised by your manager. This is a minimum requirement. As a member of the senior management term, you will be expected to devote the requisite hours for completion of all tasks and achievement of all goals. This can include work hours at night, on weekends and on holidays, as and when required. Further, you will be "on call" 24 hours per day, 7 days per week, for operational emergencies. No overtime compensation of any type is payable in connection with these additional work hours.

…

8. PUBLIC HOLIDAYS : You shall be entitled to 17 public holidays, as gazetted by the Hong Kong SAR Government. If you are scheduled to work on any statutory holidays, you will be

compensated in accordance with the Personnel Policy.

…

10. TRANSFER : You shall be subject to transfer from one work location to another location where [Company C], or any of its affiliated companies, has a presence in Hong Kong.

…

12. PROVIDENT FUND : Employer MPF contributions will be at the rate of 6%

13. EXPENSES : You will be reimbursed for expenses incurred while on business trips away from Hong Kong and for certain business entertainment expenses in Hong Kong, in accordance with company policies. These are subject to approval, in advance, by your manager, and completion and approval of the required expense forms, as well as submission of required receipts and documentation. You will be reimbursed for certain other expenses incurred as a result of operational irregularities and other situations requiring a prolonged presence at the airport. These could include hotel accommodation, transportation between the airport and your home (and v.v.) and meal expenses. In such an event, guidance may be obtained from your manager as to acceptable expenses. Completion and approval of an expense form, along with submission of receipt and supporting documentation, will required.

…

16. OTHER MATTERS : Your terms and conditions of employment will be governed by this contract and the Personnel Policy, which is available from your manager. You are required to read and

understand the contents of the Personnel Policy.

In accordance with the provisions of the Personal Date (Privacy) Ordinance of Hong Kong, by signing below, you consent to [Company C] using any personal data held by the Company in connection with your employment, and to the Company supplying such personal data to any selected third parties to use for such purposes.'

16. The aforesaid letter of employment was written on the note-paper of Company F Regional Office, Asia Pacific of the First Address and was addressed to the Taxpayer at an address in Hong Kong. This letter was signed by Mr K, Human Resources Manager of Company C.

17. By another letter of 23 November 2000 ('the Second Letter'), also written on the note-paper of Company F of the First Address, and also addressed to the Taxpayer's same address in Hong Kong, the criteria for payment of bonus were set out. This letter was signed by Mr L, described as Vice President, Asia Pacific.

18. By a letter dated 14 February 2003 ('the Third Letter') written on the note paper of both Company C and Company F, Regional Office – Asia Pacific and Middle East, of the Second Address and also addressed to the Taxpayer at the same address in Hong Kong. This letter was again signed by Mr L, described as Senior Vice President – International Operations. This letter referred to their numerous discussions and set forth the changes to the Taxpayer's aforesaid employment agreement of 23 November 2000. Those changes, inter alia, are as follows :

'1. As from 1st January 2003, your employment status has been changed to indefinite terms (For the sole purpose of seniority, your joining date will be considered as 6th January 2001.)

2. Your position as from 1st January 2003 is "Director – Systems Development". Working with all departments, but particularly International Business Development and IT Systems, you will deal with all developmental and operational issues related to [a named systems], manpower resource management systems and other matters as assigned from time to time.

…

6. Your are employed by the Hong Kong Branch of [Company C], but will be expected to support all divisions, branches, subsidiaries and affiliated companies of your employer.

7. You will be expected to travel extensively in the course of your duties. Travel policies and expense re-imbursement procedures are as provided to you from time to time. When in Hong Kong, your place of employment is Hong Kong International Airport.

8. Section 6 (Notice of Termination) of your original employment agreement is deleted in its entirety. Statutory notice and termination provisions will apply to this agreement.

9. All other provisions of your original employment agreement remain unchanged.'

19. In each of his tax returns for the years of assessment 2003/04 and 2004/05, the Taxpayer computed his assessable income by the number of days he spent in Hong Kong.

20. During investigation of the matter by the Revenue, the Taxpayer asserted that his contract of employment was negotiated and concluded with the Regional Service Vice President of Company F while he was in Country B and this should be a sufficient ground for his time basis claim. By a letter of 15 April 2005, on his objection to the tax assessment of 2003/04 he also informed the Revenue that his employer was not a Hong Kong resident company and he conducted most of his work in Country B.

21. By a letter of 12 April 2007, the Taxpayer explained to the Revenue, inter alia, that at no time during his stays in Hong Kong did he render services for his employment (albeit attending meeting, giving or taking instructions, entertaining or liaising with business associates and/or performing any other work). He later asserted in his ground of appeal that he wrongly used the word 'albeit' in his letter which should really be 'such as'.

The evidence

22. At the hearing, the Taxpayer gave evidence to the following effect. During the period from September 2002 to December 2004, he was not working in Hong Kong. He was sent to Country B by the Hong Kong company and the company in Country B fully reimbursed the Hong Kong company for all his expenses. He visited Hong Kong on a regular basis because his family was here and the child of the family was attending school in Hong Kong. When he was cross-examined on the use of the word 'albeit' in his letter of 12 April 2007, he explained that the letter was drafted for him and he signed it in a hurry and overlooked the word 'albeit'. He admitted he worked a few months in Hong Kong after the deployment in Country B. When questions were

put to him by the Board, he admitted that he answered e-mail from Country B when he spent time in Hong Kong but contended that he did not render any services for the Hong Kong office. He asserted that he worked very long hours once he was outside Hong Kong but the company was very lenient on him once he was back here. He admitted he made numerous trips back to Hong Kong in each of the assessment years in question. He told us that those trips were paid for by his employer. On the question of the locality of his employment, he admitted that he was working in Hong Kong during his first contract of employment but he was working outside Hong Kong in respect of the second contract of employment. He maintained that his second contract was negotiated in Country B. Although he was in Hong Kong over 60 days in an assessment year, he was not working at all during those days spent in Hong Kong and all he did was answering e-mail from the office in Country B.

Our findings

23. On the issue of locality of employment, during investigation of the matter by the Revenue and before the Determination was made, the Taxpayer contended that his employment was not Hong Kong sourced because his contract of employment was negotiated and concluded in Country B and in determining whether the contract was Hong Kong sourced, emphasis should not be placed on the fact that his salary was paid in Hong Kong. He also asserted that his employer was resident outside Hong Kong and he was employed by the company in Hong Kong for administrative reasons only and the company in Country B reimbursed the Hong Kong company his expenses.

24. We note from the correspondence which the Taxpayer exchanged with the Revenue, the Taxpayer contended that in accordance with DIPN No 10 (Revised), his employment should be considered as non-Hong Kong sourced. Referring to DIPN No 10, the Taxpayer was relying on the 'three factors' test promulgated by the Inland Revenue Department from the Goepfert case. Those three factors are :

(a) the contract of employment was negotiated and entered into, and is enforceable outside Hong Kong;

(b) the employer is resident outside Hong Kong; and

(c) the employee's remuneration is paid to him outside Hong Kong.

25. While it is the Inland Revenue Department's general policy to accept the existence of a 'non-Hong Kong' employment where the three factors are present, the Department also stipulates that this policy is subject to the Department's right to look beyond these factors in appropriate cases. We share Macdongall J's view expressed in the Goepfert case that in determining the source of employment, one may look behind the appearances to discover the

reality and is entitled to scrutinize all evidence, documentary or otherwise, that is relevant to the matter and this process may equate to the application of the so-called 'totality of facts' test.

26. Be that as it may, whether the 'totality of facts' test or the 'three factors' test be applied in this appeal, we find that the Taxpayer has failed to discharge the burden on him to prove that his employment was not located in Hong Kong. Firstly, the Taxpayer contended that his contract of employment since 1 January 2003 was negotiated and concluded in Country B and he was employed by Company C, a company incorporated in Country B. In this regard, he relied on the letters of 17 July 2006 and 13 April 2005 written by Ms M, the Regional Financial Controller, and the said Mr L, the Executive Vice President, of Company C, respectively. The Regional Financial Controller explained to the Revenue that the second employment contract dated 14 February 2003 was negotiated and concluded in Country B because the first employment contract dated 23 November 2000 was so negotiated and concluded and the second employment contract dated 14 February 2003 clearly stated that the commencement date of the Taxpayer's employment was 6 January 2001. In his letter, the Executive Vice President said that the negotiation of the second employment contract took place in Country B where the Taxpayer was working prior to the signing of the contract. We find it unsafe for us to rely on the aforesaid evidence to conclude that the second contract of employment dated 14 February 2003 was negotiated and concluded in Country B. Firstly, as to the explanation given by the Regional Financial Controller, it is illogical for her to say that the second employment contract was negotiated and concluded in Country B simply because the Taxpayer's employment was treated as having commenced from his first contract of employment which was negotiated and concluded in Country B. Her evidence cannot substantiate the Taxpayer's contention. As to the Executive Vice President's evidence, he only said that the contract was negotiated in Country B. He did not say that it was concluded in Country B. On the other hand, we have clear evidence that the First Letter, the Second Letter and the Third Letter were prepared by the company using its address in Hong Kong and these letters were also sent to the Taxpayer in Hong Kong. We therefore find that these contracts were entered into in Hong Kong. We find it safer to rely on contemporaneous documents rather than those made after the fact and which seemed self-serving.

27. As to the Taxpayer's claim that his employer was not a company resident in Hong Kong, we have the following findings. The Taxpayer's employer was the Hong Kong Branch of Company C as stated clearly in the First letter and the Third letter. Although Company C was incorporated in Country B, the company was also registered in Hong Kong as an overseas company under Part XI of the Companies Ordinance and it was maintaining a place of business in Hong Kong at all the relevant times. The Hong Kong Branch could sue or be sued in Hong Kong. The Hong Kong Branch filed employer's returns in respect of its employees in Hong Kong, including the ones of the Taxpayer. It is therefore quite clear that the employer was carrying on business and had a presence in Hong Kong at the material time. Although the First letter was written on the note-paper of Company F, it was done in Hong Kong with note-paper bearing the First Address which was in Hong Kong and signed by Mr K the Human Resources Manager for and on behalf of Company C. The Second Letter was written and signed by Mr L as

Vice-President, Asia Pacific on the note-paper of Company F but also bearing the First Address in Hong Kong. The Third Letter was written and signed by Mr L as Senior Vice President – International Operations on the note-paper of Company C and Company F also bearing the Second Address which was in Hong Kong. Company F was a director of Company C. It was also registered as an overseas company in Hong Kong and maintained a place of business in Hong Kong. The Taxpayer's employer was the Hong Kong Branch of Company C. From these facts, we have no doubt that the Taxpayer's employer was resident in Hong Kong.

28. During investigation of the matter, when the Taxpayer contended that he was employed by the company in Country B, he was asked by the Revenue to supply evidence, if any, that the Taxpayer paid tax in Country B for his employment. The Taxpayer did not provide any evidence or information in this regard.

29. It is common ground that the Taxpayer's remuneration was paid to him in Hong Kong and the Hong Kong Branch of Company C filed the Taxpayer's tax returns in Hong Kong. There is no evidence to support the Taxpayer's contention that Company C reimbursed the Hong Kong Branch his remuneration or other expenses.

30. Apart from the above evidence which is relevant to the 'three-factors' test, there is ample other evidence for us to reach the conclusion that the Taxpayer's employment was Hong Kong sourced. The Taxpayer was provided with housing in Hong Kong. He participated in the Hong Kong Mandatory Provident Fund. His entitlement to public holidays was in accordance with the laws of Hong Kong. His employer's use of his personal data was also in accordance with the laws of Hong Kong. In his first employment contract, he was employed to work specifically in Hong Kong and only in his second employment contract that, apart from performing his duties in Hong Kong, he was expected to travel extensively in the course of his duties. In both the First Letter and the Third Letter, it was stated clearly that he was employed by the Hong Kong Branch of Company C. These facts strongly support the finding that the Taxpayer's employment was Hong Kong sourced.

31. Since the Taxpayer's employment was Hong Kong sourced, all his employment income would be chargeable to salaries tax under section 8(1) of the IRO. However, if it can be proved that he did not render any services for his employment during his stays in Hong Kong in the assessment years in question, his entire income will be exempt from salaries tax under section 8(1A)(b).

32. The Taxpayer in this appeal contended that during the period of deployment in France between 23 September 2002 and 21 December 2004, he did not render any services in Hong Kong when he visited Hong Kong during this period of time. The assessment years in question are 2003/04 and 2004/05. By his own admission and also from the information provided by the Regional Financial Controller, the Taxpayer did render services in Hong Kong before and after the period of deployment in Country B. Thus we only need to concern ourselves with the assessment

year 2003/04. All the employment income of the assessment year 2004/05 is chargeable to salaries tax because the Taxpayer did perform work in Hong Kong after the deployment which ended on 21 December 2004.

33. In his tax returns of both assessment years 2003/04 and 2004/05, the Taxpayer claimed apportionment of his salaries tax on a time-in and time-out Hong Kong basis. During the investigation by the Revenue, the Taxpayer claimed that his employer was not a company resident in Hong Kong and he conducted most of his work in Country B. By her letter to the Revenue of 11 August 2006, the Regional Financial Controller of Company C, Hong Kong Branch, provided the Revenue with the information that before and after the Taxpayer's deployment in Country B, the Taxpayer rendered services both in Hong Kong and City N; the Taxpayer worked five days a week and nine hours a day in any place where he worked; and the Taxpayer was required to travel and was seconded to other subsidiaries or affiliated companies of Company C. By his letter to the Revenue of 12 April 2007, the Taxpayer informed the Revenue that at no time during his stays in Hong Kong did he render any services in Hong Kong (albeit attending meeting, giving or taking instructions, entertaining, or liaising with business associates and/or performing any other work). However, the Taxpayer changed his stance in his ground of appeal, alleging that the word 'albeit' in his letter was a mistake and this word should be replaced by the words 'such as'. We find the explanation given by the Taxpayer at the hearing unconvincing. His explanation was that the letter was written by someone else and he overlooked the word 'albeit' when he signed the letter in a hurry. Since this letter to the Revenue was a letter containing information which was personal to the Taxpayer, even if it was drafted for him by someone else the information contained in the letter ought to have come from the Taxpayer himself and not from the writer. Since this letter is an important letter to be used by the Taxpayer to substantiate his case, we are not convinced that the Taxpayer should sign it in a hurry as claimed, thus allowing a detrimental mistake to occur. Initially, the Taxpayer claimed apportionment of salaries tax on a time-in and time-out Hong Kong basis and did not allege that he did not work at all in Hong Kong during his visits. We are of the view that the Taxpayer changed his stance only after reading the Determination in which the Deputy Commissioner determined that the Taxpayer's employment was Hong Kong located and the Taxpayer was not entitled to exemption under section 8(1A)(b) because in his own admission the Taxpayer had rendered services in Hong Kong such as attending meetings, giving and taking instructions, and entertaining or liaising with business associates. Having rejected the Taxpayer's oral evidence as to the mistake made, we have on the other hand, objective evidence that the Taxpayer spent 117 days in Hong Kong in the assessment year 2003/04; the Taxpayer was required to work five days a week and nine hours a day anywhere he worked; and the Taxpayer was expected to travel extensively in the course of his duties. The Taxpayer also told us that his numerous trips to Hong Kong during the years of assessment in question were paid for by his employer. That being the case, we wonder why the employer would pay for these trips if these trips were only for personal reason. Taking all the foregoing evidence into consideration, it is difficult for us to find that the Taxpayer was totally divorced from work during his visits to Hong Kong in the assessment year of 2003/04 or 2004/05.

34. Accordingly, we conclude that the Taxpayer' s employment was Hong Kong sourced and the Taxpayer did render services for his employment in Hong Kong in the assessment years 2003/04 and 2004/05 and the Taxpayer' s employment income for both the assessment years 2003/04 and 2004/05 is chargeable to salaries tax in Hong Kong. The appeal of the Taxpayer is dismissed.