Case No. D10/84

Board of Review:

William Turnbull, *Chairman*; Ho Yiu-wah & Robert C. Kwok, *Members.*

25 July 1984.

Salaries tax—section 8(1) of the Inland Revenue Ordinance—employee of multi-national group seconded to Hong Kong—whether office or employment of profit in Hong Kong.

The appellant was an employee of a New Zealand company. He was assigned to work for the Hong Kong Branch of a company incorporated in USA which was a member of the same multi-national group as the New Zealand Company. The appellant was assessed to Salaries Tax on his whole salary while in Hong Kong. The appellant appealed on the ground that he had no office or employment of profit in Hong Kong.

Held:
Whether the appellant had an office or employment of profit in Hong Kong is to be decided on the totality of the facts and in this case on that test the appellant was employed in Hong Kong.

Appeal dismissed.

Lee Kwok-leung for the Commissioner of Inland Revenue.
Patrick B. Paul of Messrs. Price Waterhouse for the appellant.

Reasons:

This appeal is a claim by the Tax Payer that his taxable income should be reduced pro rata to the periods which he spent outside of Hong Kong performing his duties—the "days in, days out" principle. The Tax Payer was an employee of a multi national Group of Companies employed in his home country outside of Hong Kong. He was sent to Hong Kong on secondment to work for a period of two years.

The representative for the Tax Payer submitted that the Tax Payer had no office or employment of profit in Hong Kong and accordingly was not assessable to tax under section 8(1) of the Ordinance. He submitted that the Tax Payer could only be assessed to tax under the provisions of section 8(1A) of the Ordinance.

It was common ground between the Tax Payer and the Revenue that the case should be decided on the totality of the facts. The question for this Board to decide is whether or not the Tax Payer had an office or employment of profit in Hong Kong.

The Tax Payer was not able to appear himself to give evidence but two able and knowledgeable witnesses gave evidence for the Tax Payer and both were cross examined by the representative for the Commissioner.

The Tax Payer's representative asked us to pay particular attention to the true nature of the corporate entity to which the Tax Payer was assigned in Hong Kong and the nature of the Tax Payer's specific duties with that entity. Much time was spent on the first of these two points. There was a company incorporated in U.S.A. with the name XA. This company was part of the world wide XE. The XG was a very large group of companies operating throughout the world and in particular operating in some 13 Asian countries. The complexity of controlling and managing operations in so many countries simultaneously prompted the XG to establish XA for the purpose of assisting in the management and control of the XG operations in the 13 Asian countries. XA was not involved in the marketing or sale of any of the XG products. Its sole function was to operate internally within the XG as part of the world wide management and control structure of the XG.

XA operated two main branches, one in Japan and one in Hong Kong. It had registered itself as a foreign corporation carrying on business in Hong Kong under the provisions of our company law. XA established a substantial branch office at C in Hong Kong occupying the whole or part of three floors with a staff of some 85 persons. This branch of XA which operated in Hong Kong is referred to as Z.

Z operated on the basis that it was entitled to recover its expenses of operation plus a 10% mark-up on such expenses for another XG Company namely E. These expenses were then consolidated with any other relevant expenses of E and were charged by E to the XG operating companies in the 13 countries for which Z had responsibility. Z billed and carried in its accounts the full amount of its expenses plus the 10% mark-up but had only been paid on a cash flow requirement basis with the balance carried forward as a receivable in its accounts.

There was some conflict between the Tax Payer and the Commissioner with regard to the contract if any under which Z performed its services. According to the files of the Inland Revenue Department the reimbursement of expenses and the 10% charged by Z for its services was effected under the terms of a long standing agreement with XA made in 1961. The Tax Payer's representative claimed that this agreement was no longer in effect and that there was some other arrangement. It appeared that the Tax Payer's representative was trying to argue that the 1961 agreement no longer applied and that Z no longer received or was entitled to receive anything other than reimbursement of its actual expenses. Insofar as this is relevant to the Tax Payer's appeal this Board has no hesitation in finding that Z was entitled to and did bill and include in its accounts the full amount of its expenses plus a 10% gross profit in respect of the services which it provided. Z issued debit notes on this basis and maintained its audited accounts and filed Tax Returns in Hong Kong on this basis. Whether Z chose to recover in cash the 10% mark-up or whether it chose to allow it to continue as a debt due to it from another XG company is not material. It did bill the 10%, it did show the 10% in its annual profit and loss statements and it did carry the accumulative

10% as an asset in its Balance Sheet. To suggest otherwise could have serious consequences upon those who maintained the Z records and accounts and who filed its Tax Returns. It is sufficient to place on record with regard to this point that evidence was given on oath that the audited accounts of Z were true and correct.

The representative of the Tax Payer argued that Z was a cost centre and not a profit centre, that it was not trading, that the 10% mark-up was fictional and not real, and that it volunteered payment of tax because it was a good citizen. With due respect we cannot agree with this submission and the facts do not substantiate it. It is true that Z was not a trading company. It is true that Z within the XG was a cost centre and not a profit centre. That is as far as the submission can go. Z was a service organisation providing services within the XG. It maintained its own accounts and operated its own branch in Hong Kong. It operated on a book profit which was also a legal profit.

We have set out in some detail the facts and submissions with regard to Z because these formed a major part of the submission made on behalf of the Tax Payer by his representative. However it is only one aspect of this appeal. If the appeal turned entirely on this point then we would have no hesitation in rejecting the Tax Payer's submissions and upholding the Commissioner's determination. However the real crux of this case is to decide whether or not the income which the Tax Payer received from his employment arose in or was derived from Hong Kong. To ascertain this we must look at the totality of the facts.

The Tax Payer was employed by a company which for convenience we will call XN. It was a company within the XG which is incorporated in New Zealand and carried on its business in New Zealand. So far as we are aware it did not carry on any business outside of New Zealand. The Tax Payer was a full time employee of XN and it was the apparent intention of both the Tax Payer and XN that he should be a permanent employee with long term career prospects within XN. Z had a vacancy for a Manager in charge of Financial Systems. It referred to E and E identified the Tax Payer as a possible person to fill the vacant post provided that the Tax Payer and XN were in agreement. The Tax Payer was approached by XN and he came to Hong Kong with his wife in accordance with the standing procedures of the XG. We were told that no one was ever assigned to a foreign location unless both he and his wife had first visited the location to ensure that they liked the place to which the employee was being assigned.

We were told that the XG procedure was then for the employee and his career manager to negotiate suitable terms which were agreed verbally and then confirmed in writing. Although the Tax Payer in this case was not able to give evidence himself we have no doubt this procedure was duly followed.

The written confirmation comprised a lengthy 8-page document dated 3 September 1980 in the form of a memorandum to the Tax Payer entitled
"Your Assignment to: Hong Kong
as: Manager of Financial Systems".

The memorandum commenced with the following three paragraphs:—

> "This memorandum confirms our discussions and your discussion with B, your Career Manager relative to the terms and conditions of your assignment.
>
> It is anticipated that your international assignment, which is effective 14 September 1980, will be for a period of two years. It should be understood, however, that the length of your assignment is based upon present requirements and is subject to change at the discretion of X.
>
> Your international assignment employer is the XA who would be bearing all costs of the assignment. Upon completion of the assignment you will return to your home country. While you are on assignment, the provisions of the International Assignment Plan as amended, will apply."

In setting out the financial terms of compensation to be said to the Tax Payer the memorandum includes the statement "your assignment work location in Hong Kong".

This memorandum left little room for doubt as to the location of the Tax Payer's assignment. He was not a New Zealand employee being sent to work in some thirteen Asia countries one of which was Hong Kong. He was an employee employed by one company within the XG who was being sent on full time assignment to work in the office maintained in Hong Kong by another XG Company.

The Tax Payer's representative stressed that the nature of the services provided by Z were of a regional nature and that the Tax Payer was employed to work for Z in performing these regional services. That may well be the case but begs the question of where the Tax Payer was employed. In his final submission the Tax Payer's representative stressed the importance of New Zealand because the Tax Payer had an ongoing employment with XN. He went on to say that the Tax Payer's job was regional in nature with traveling round the region a necessary condition of the work. He said that the Tax Payer was employed by XN.

There is some doubt in our minds whether it is correct to say that the Tax Payer's employer was XN. On the facts XA cannot be totally ignored. In reality there was a contractual relationship between the Tax Payer and both XN and XA through its Z office. When filing an Employers Tax Return Form (I.R. 56B) Z clearly stated that it was the employer of the Tax Payer. Furthermore P when giving evidence referred to a number of occasions to Z and/or XA as being the employer. The Board finds nothing unusual in such a situation. Employees of multi national groups of companies such as the XG may often be transferred or assigned to overseas countries. Their home country employment does not terminate but continues on a dormant or semi-dormant basic depending on the circumstances and the operating methods of the group. In this case the Tax Payer's home employment became semi-dormant. His promotion and long term career prospects and certain fringe benefits were dependent on his home country employer, namely XN. However he was sent on assignment to Z in Hong Kong and Z became his immediate employer during the period of his assignment. This is crystal clear from the facts.

He was sent on assignment to Hong Kong and his job included traveling round the Asian region. He was not employed by XN to work in the Asian region including Hong Kong. His office was in Hong Kong. His immediate superior from whom he took instructions and to whom he reported in the ordinary course of his work was in Hong Kong. He worked for Z on assignment to enable Z to perform the services which it carried out for the XG. XA which was the legal entity to which the Tax Payer was assigned had a substantial office in Hong Kong namely Z. It was to that office that the Tax Payer was assigned.

Looking at the totally of the facts before us we have no difficulty or hesitation in deciding that the Tax Payer was employed by Z in Hong Kong and accordingly we confirm the Commissioner's determination.