Case No. D110/00

Salaries tax – income received as consultant fees – whether income derived from an ‘office or employment of profit’ or income for a business – sections 8 and 16 of the Inland Revenue Ordinance (‘IRO’).

Panel: Benjamin Yu SC (chairman), Herman Fung Man Hei and Paul Ng Kam Yuen.

Date of hearing: 16 October 2000.
Date of decision: 20 December 2000.

The Commissioner determined that the income of $480,000 and $490,000 received by the taxpayer during the relevant years of assessment were income derived from an ‘office or employment of profit’ and taxable under section 8 of the IRO.

In this appeal, the taxpayer contended that the sums of $480,000 and $490,000 were not received by him as salary, but was received by his sole proprietorship business called ‘Company B’ as consultant fees. He claimed that he should not have been taxed on the income, but only on the net profits of that business.

The issue in this appeal was whether the said sums were received by the taxpayer as income derived from an ‘office or employment of profit’ and taxable under section 8 of the IRO, or as income for a business, so that only the profits are taxable under section 16 of the IRO.

Held:

1. The expression ‘salaries’ tax does not fully reflect the nature of the charge. It is important to realize that the charge under section 8 covers not only salary as is commonly known but also any income derived from an office of profit. Such, a fee paid to anyone for holding an office, such as directorship of a company, is taxable under section 8.

2. On the evidence, the Board found that the income described as consultant fee, was income derived from an office or employment of profit (D162/98 considered).

3. Freedom to work for others, or flexible working hours, is not inconsistent with a contract of service (Market Investigations v Minister of Social Security [1969] 2 QB 173 at 186F-G and D178/98, IRBRD, vol 14, 68 considered and applied).

4. The Board found that he taxpayer did have a contract of employment with Company F during the relevant years of assessment, and that the consultant fees received by his company, Company B, was income derived from that employment. Though he may not be an ordinary employee, he nevertheless was an employee.

Appeal dismissed.

Cases referred to:

Market Investigations v Minister of Social Security [1969] 2 QB 173
D178/98, IRBRD, vol 14, 68

Wong Ki Fong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The appeal

1. This is an appeal by Mr A ('the Taxpayer') against a determination by the Commissioner of Inland Revenue dated 28 April 2000. In that determination, the Commissioner reduced the salaries tax assessment of the Taxpayer for the year of assessment 1995/96 to $309,000 with tax payable thereon of $54,000 and reduced the salaries tax assessment of the Taxpayer for the year of assessment 1996/97 to $302,000 with tax payable thereon of $52,600.

2. These assessments were arrived at by taking the Taxpayer's income for the relevant years of assessment, that is, 1995/96 and 1996/97 as $480,000 and $490,000 respectively, and, in each case, allowing a 10% deduction for expenses and a further deduction on account of personal allowance. The calculations are as follows:

Year of assessment	1995/96	1996/97
	$	$
Income	480,000	490,000
Deduction for expenses	48,000	49,000
	432,000	441,000

Personal allowance	123,000	139,000
Chargeable income	309,000	302,000
Tax	54,000	52,600

3. In her determination, the Commissioner concluded that the income of $480,000 and $490,000 received by the Taxpayer during the relevant years of assessment were income derived from an ‘office or employment of profit’ and taxable under section 8 of the IRO. In this appeal, the Taxpayer contends that the sums of $480,000 and $490,000 were not received by him as a salary, but was received by his sole proprietorship business called ‘Company B’ as consultant fees. He claims that he should not have been taxed on the income, but only on the net profits of that business. On the basis of the accounts of Company B, the Taxpayer reported the net profits for that business as $46,270 and $54,247 for the relevant years of assessment.

4. The issue in this appeal is therefore whether the sums of $480,000 and $490,000 were received by the Taxpayer as income derived from an ‘office or employment of profit’ and taxable under section 8 of the IRO, or as income for a business, so that only the profits are taxable under section 16 of the IRO.

The facts

5. The following facts are not controversial and we find them proved:

(1) In April 1993, the Taxpayer applied for business registration of a sole proprietorship business under the name of Company B. Its business was described in the application as ‘consultant and trading’.

(2) In October 1994, the Taxpayer caused a company to be incorporated in the name of Company C. The only two directors were the Taxpayer himself and a Mr D. The Taxpayer held 9,998 out of 10,000 shares issued by Company C.

(3) In November 1994, a company called Company E was incorporated. That company later changed its name to Company F. Company F had two shareholders: Company G, which held 70% and Company C, which held 30%. Company G and Company C were also directors of Company F.

(4) By a document dated 8 May 1995, entitled ‘Contract’, Company F and Company B recorded an agreement that Company F used Company B as their ‘consulting agent’ with effect from 21 November 1994. The responsibility of Company B was described as ‘liaison between all customers ... project development, project quotation and project

monitoring'. The document further recorded the understanding that Company B 'assigns' the Taxpayer to be the representative. Company F agreed to pay consultant fee of $25,000 per month, with 14 months per annum.

(5) Company F and Company B executed another document in May 1995, but dated 30 May 1995, which contained the same terms as the one dated 8 May 1995 except that the consultant fee was stated to be $35,000.

(6) In May 1997, Company F filed an employer's return of remuneration and pensions for the year ended 31 March 1996 and another one for the year ended 31 March 1997. In both returns, Company F reported that 'salary/wages' were paid to the Taxpayer/Company B and described the capacity in which the Taxpayer/Company B was employed to be 'director'.

Evidence

6. The Taxpayer gave evidence before the Board. He told us that Company B ran a trading business in high technology products. In 1994, he was invited by the G Group to form Company F. He referred us to the minutes of a meeting held in November 1994 which recorded that agreement. According to the Taxpayer, the minutes were prepared by him. Those minutes recorded, inter alia, that

(1) the Taxpayer will be working at Company F s office starting from 20 November 1994,

(2) the Taxpayer will receive a consultant fee of $25,000 per month from the G Group every month,

(3) apart from this, any gasoline, transportation, entertainment and telephone call expenses will be reimbursed from the G Group;

(4) in every year, Company F will reserve 8% of the net profit (after tax) as management bonus. At this moment, only the Taxpayer was entitled to this bonus;

(5) in order to show mutual effort to develop Company F, every party should sign personal guarantee whenever Company F needed to use bank's facility;

(6) the Taxpayer' s responsibility include daily communications with customers and internal departments, quotation co-ordinations, costing evaluation and preparing enough information for cost department to work with. On top of this, the Taxpayer was to generate more customers and business for Company F.

(7) The Taxpayer' s office was located at the third floor of the building of the G Group.

(8) A separate fax machine as well as a private telephone line will be installed in the Taxpayer' s office.

(9) Ms H will assist the Taxpayer for daily clerical jobs.

7. According to the Taxpayer, the G Group did not fully accept the accuracy of the minutes. The Group refused to reimburse him for gasoline, transportation or entertainment expenses. He therefore had to pay for these expenses out of the consultancy fee earned. He claimed that he was not treated as an employee of the company because, unlike other staff,

(1) he did not enjoy normal employment benefits, such as annual leave, medical and pension fund,

(2) he was not precluded from carrying on his own business.

He told us that he only spent part of his time working for Company F, and for the rest, he continued with the trading business of Company B.

8. Although Company C was named as a director of Company F for the purpose of registration under the Companies Ordinance, the Taxpayer carried a business card describing himself as a director of Company F. In dealing with clients, he would therefore be holding himself out as a director of the company.

9. The position changed, according to the Taxpayer, in April 1997. He caused Company C to sell all its shares in Company F to the G Group. He became an employee, and his remuneration was increased to $50,000 per month. This change came about because the Taxpayer realized that he was not getting any benefit out of profits made by Company F. According to him, the G Group increased the administrative charges levied by the Group on Company F whenever Company F made any profit, with the result that he never received any of the 8% bonus he thought he bargained for in 1994. By 1997, he reckoned that he would be better off with a revised deal whereby he could look to a fixed sum of remuneration by way of salary, together with all the benefits associated with employment, rather than hold the 30% share with no actual

return. Despite the sale of his shares, he remained as engineering and marketing director of the Group.

10. In cross-examination, the Taxpayer was shown a document dated 5 April 1997 whereby Company F agreed to pay consultant fee of only $14,000 per month to Company B. The Taxpayer' s explanation was that this only reflected part of his remuneration. He was quite sure that his total package amounted to $50,000 per month, and surmised that the balance (that is, $50,000 - $14,000) must have been structured under another company within the same Group. The Taxpayer also produced to us documents which suggested that his entitlement under the pension fund scheme commenced in April 1997.

Our findings and reasons therefor

11. We find the Taxpayer to be a truthful witness and would accept his evidence as to primary facts. This does not, however, mean that we accept the inference he asks us to draw, nor does it mean that we accept his arguments. Rather, it falls upon us to determine, on the basis of the evidence as to primary facts he has given, whether the Taxpayer was liable to pay salaries tax under section 8. Before doing so, we should point out that the expression ' salaries tax' does not fully reflect the nature of the charge. It is important to realize that the charge under section 8 covers not only salary as is commonly known but also any income derived from an office of profit. Thus, a fee paid to anyone for holding an office, such as directorship of a company, is taxable under section 8.

12. For the period prior to April 1997, that is, the period we are concerned with in this appeal, the Taxpayer had two different relationships with the G Group. Firstly, through his Company C, he was a 30% shareholder of Company F. Secondly, he occupied a relatively senior position in Company F – a position no different from that of a director; and he derived an income (or consultant fee) for working for the company. As he himself explained, he was prepared to forego many of the benefits that an employee was entitled to at the time when he was a shareholder, in the expectation that he would get his return through sharing the profits. Quite naturally, he did not regard himself as an ordinary employee of the company.

13. However, whether the income he derived, in the name of Company B, from Company F was income derived from an ' office or employment of profit' depends on objectively what was the nature of that income rather than his subjective understanding. On the evidence, we have no doubt that the income, described as consultant fee, was income derived from an office or employment of profit, and we so find. We find that the Taxpayer held a position or office of profit in Company F and his remuneration was referrable to that position or office. We have been referred to the decision of this Board in D162/98. That was a case where money was paid to a company controlled by the Taxpayer in the form of consultancy fee, but found by the Board in substance to be remuneration for the Taxpayer holding the office of directorship. In the present case, the Taxpayer was paid a monthly sum, likewise labelled as consultant fee, for the services he provided as a de facto director of Company F.

14. Miss Wong, for the Respondent, has submitted that the Taxpayer was an employee of Company F during the relevant years of assessment. In other words, it is said that the Taxpayer had a contract *of* service, rather than a contract for services, with Company F. We accept the submission that freedom to work for others, or flexible working hours, is not inconsistent with a contract of service: see Market Investigations v Minister of Social Security [1969] 2 QB 173 at 186F-G and D178/98, IRBRD, vol 14, 68. Our attention has also been drawn to the following factors which point in favour of the relationship being one of employment:

(1) the Taxpayer was provided with an office; he was provided with office equipment;

(2) the Taxpayer was even provided with an office assistant; (Miss Wong pointed out, and the Taxpayer accepted in evidence, that although Company B hired two staff, they only handled the trading business of Company B and did not assist the Taxpayer in respect of his work for Company F.)

(3) the work of the Taxpayer was supervised by the board of Company F, and he was answerable to the board of directors;

(4) the Taxpayer's remuneration was fixed on a monthly basis, and he was also entitled to an extra two months' pay, which was very similar to the payment of salary and year-end bonus;

(5) the work that the Taxpayer undertook, that is, liaison between all customers, project development, project quotation and project monitoring etc was essentially the work normally undertaken by an employee.

15. We agree with Miss Wong's submission and, if it be necessary, we find that the Taxpayer did have a contract of employment with Company F during the relevant years of assessment, and that the consultant fee received by his company, Company B, was income derived from that employment. We have earlier stated that we could understand why the Taxpayer did not regard himself as an employee. In our view, whilst he may not be an *ordinary* employee, but nevertheless he was *an* employee. As we observed above, the fact that the Taxpayer did not enjoy all the benefits of an ordinary employee of Company F is explicable by the fact that he expected then that his sacrifices in terms of normal employment benefits would be compensated for by the returns he would make as a shareholder. Equally, his commitment to sign personal guarantee to support Company F was referable to his relationship with the company as a shareholder. Neither detracts from the conclusion that in substance the relationship between him and Company F was one of employment.

16. For these reasons, we dismiss the appeal and confirm the assessments.