Case No. D11/12

Salaries tax – whether employment income or distribution of profits / dividend – whether Hong Kong employment – sections 8, 8(1A), 9(1)(a) and 68(4) of the Inland Revenue ordinance ('the IRO').

Panel: Colin Cohen (chairman), Wong Wang Tai Fergus and James Todd Wood.

Dates of hearing: 13 and 14 February 2012.
Date of decision: 6 June 2012.

The Taxpayer signed the Employment Agreement dated 1 June 2003 with Company CC as his employer.

The Taxpayer contends that the relevant sums for the years of assessment 2003/04 to 2005/06 that were referred to in the Determination ('the Sums') were NOT income from his employment with Company CC but distributions or dividends to him as equity partner of Company CB2.

Alternatively, the Taxpayer contends that any employment relationship in existence, which he denies, would be a non-Hong Kong employment and any income derived there from should be subject to apportionment under section 8(1A) of the IRO.

Held:

1. The Taxpayer was an employee of Company CC in view of the Employment Agreement with Company CC which onwards filed the employer's returns for the relevant years in respect of monies received by the Taxpayer.

2. The Taxpayer was not a partner of Company CB2:

   2.1 The Shareholders' Agreement and the Employment Agreement were intended to be legally binding. The terms of the Shareholders' Agreement clearly show that the Taxpayer was not a partner in Company CB2.

   2.2 There was never any partnership agreement which the Taxpayer could point to which could give rise to him being a partner of Company CB2.

   2.3 Company CC was a corporate partner of Company CB2. The Taxpayer

and his peers were in turn the shareholders and employees of those corporate partners.

2.4 There was no evidence to suggest that any payments made by the Taxpayer were a contribution to the capital in his capacity as a partner.

2.5 There was no evidence to support the Taxpayer's contention that he received a share of profits from Company CB2.

2.6 The Taxpayer fails to prove as a matter of law and in fact that he was a partner of Company CB2.

3. The Taxpayer was an employee and a shareholder of Company CC. Yet, there was no evidence to show that the Sums were dividend income from his shareholding in Company CC.

4. The Taxpayer's employment with Company CC was a Hong Kong employment:

4.1 It was the Taxpayer's own case that the choice of law/jurisdiction clause was only a standard term.

4.2 The Taxpayer was recruited in Hong Kong. He and his team were brought in to expand Company C's operations in Hong Kong.

4.3 A significant portion of the Taxpayer's work had a direct relationship with Hong Kong, and the Taxpayer had established a very successful legal practice in Hong Kong.

4.4 The Taxpayer spent a considerable amount of his time in Hong Kong – 216 days in 2003/04, 241 days in 2004/05, and 257 days in 2005/06.

4.5 Company CC was to maintain a principal office in Hong Kong and throughout the Taxpayer's employment he was paid in Hong Kong.

4.6 The controlling power and authority of Company CC was in Hong Kong and that Company CC was resident in Hong Kong.

Appeal dismissed.

Cases referred to:

CIR v Goepfert (1987) 2 HKTC 210
Ross v Parkyns (1875) LR 20 Eq 331

Stekel v Ellice [1973] 1 WLR 191
Kao, Lee & Yip v Edwards [1994] 1 HKLR 232
Young v Zahid [2006] 1 WLR 2562
McEntire v Crossley Bros Ltd [1895] AC 457
IRC v Duke of Westminster [1936] AC 1
NZI Bank Ltd v Euro-National Corporation Ltd [1992] 3 NZLR 528
Kwong Mile Services Ltd v CIR (2004) 7 HKCFAR 275
Esquire Nominees Ltd v FCT (1973) 129 CLR 177

Ann Lui Counsel instructed by Messrs Leung & Associates for the Taxpayer.
Yvonne Cheng Counsel instructed by Department of Justice for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal by Mr A ('the Taxpayer') in respect of objections he has raised to the salaries tax assessments for the years of assessment 2003/04 to 2005/06 ('the Assessments').

2. By virtue of a Determination dated 28 April 2011 ('the Determination'), the Deputy Commissioner of Inland Revenue ('the Commissioner') confirmed the Assessments. In respect of the year of assessment 2003/04, the Commissioner confirmed the net income of $3,931,568 with tax payable thereon in the sum of $609,393. In respect of the year of assessment 2004/05, the Commissioner confirmed the net income of $9,259,376 with tax payable thereon in the sum of $1,481,500. In respect of the year of assessment 2005/06, the Commissioner confirmed the net income of $9,205,410 with tax payable thereon in the sum of $1,472,865.

3. By a letter dated 26 May 2011, the Taxpayer's tax representative, CCIF CPA Limited ('CCIF') lodged an appeal. There were six grounds of appeal. They are:

> ' (a) The quantum of the taxable income for the years of assessment 2003/04, 2004/05 and 2005/06 is excessive.
>
> (b) The Sums (which were referred to Sum A, Sum B and Sum C in the Statement of Facts and collectively known as "The Sums") were distributions from [the Country B partnership, Company CB2 (formerly Company CB1) in Country B], in [the Taxpayer's] capacity as one of the equity partners/shareholders of [Company CB2]. The distributions were made from the profits of [Company CB2]'s worldwide income and

should be non-taxable. The Sums were outside the scope of charge to Hong Kong Salaries Tax and Hong Kong Profits Tax.

(c) The Sums were NOT employment income of [the Taxpayer] from [Company C (Country U) PC ('Company CC') nor Company C (Hong Kong) ('Company CD2')].

(d) The Sums were paid to [the Taxpayer] directly from [Company CB2 in Country B] with a portion paid via [Company CD2] as monthly drawings. [Company CC] had never sent any funds to our captioned client.

(e) The compensations (which were in fact distributions or dividend income) of [the Taxpayer] were determined by [Company CB2] and NOT by [Company CC].

(f) [Company CC] was incorporated in [Country B]. It did not have a principal place of business nor principal office address in Hong Kong. Our captioned client had only sent notices to [Country B] directly. If there was any employment relationship in existence, which is denied, it would still be a non-Hong Kong employment and any income derived therefrom should be subject to apportionment under section 8(1A) of the Inland Revenue Ordinance.'

4. For the sake of completeness, we note that the final ground above was amended shortly before the conclusion of the hearing with the consent of the Commissioner.

5. A directions' hearing was fixed on 22 November 2011. Various directions were given at that time, including an order allowing the Taxpayer to adduce expert evidence if he so wished. Ultimately, however, the Taxpayer did not adduce any such evidence before the Board.

The issues before the Board

6. The primary issue before the Board was whether or not the relevant sums that were referred to in the Determination, that is Sum A ($9,155,410), Sum B ($4,082,068) and Sum C ($9,211,376) ('the Sums'), were income from employment with Company CC within the meaning of section 8 of the Inland Revenue Ordinance ('IRO') as had been determined by the Commissioner.

7. The Taxpayer's case is that the Sums were distributions paid to him in his capacity as one of the equity partners of Company CB2 (formerly known as Company CB1) in Country B out of its profits from its worldwide operations and that the Sums were dividend income from an overseas partnership. As such, the Taxpayer concludes that the Sums were offshore income and were outside the scope of charge to Hong Kong salaries tax

and Hong Kong profits tax.

8. A secondary issue was whether the Taxpayer's employment (if any employment relationship was found to exist between the Taxpayer and Company CC) was a Hong Kong employment.

9. In regard to this secondary issue, the Taxpayer's case was that, if any employment relationship existed, it would still be a non-Hong Kong employment and any income derived therefrom should be subject to apportionment under section 8(1A) of the IRO.

The agreed facts

10. Various directions were given by the Board to encourage the parties to agree facts. Subsequently, various agreed facts were put before the Board. Those facts were later amended and a final amended statement of agreed facts was put before the Board at the hearing. Having carefully considered the amended statement of agreed facts, we find them to be facts and now set them out as follows:

> ' (1) [Mr A ("the Taxpayer")] has objected to the Salaries Tax Assessments for the years of assessment 2003/04 to 2005/06 raised on him. In essence, the basis of his objection is that the sums in question (respectively referred to as Sum A, Sum B and Sum C below, and collectively referred to as "the Sums") were distributions he received from [the Country B partnership, Company CB2 (formerly known as Company CB1) in Country B] in his capacity as one of the equity partners/shareholders of [Company CB2], and that the distributions were made from the profits of [Company CB2]'s worldwide operation. As such, they were dividend income from an overseas partnership, and were outside the scope of charge to Hong Kong Salaries Tax and Hong Kong Profits Tax.
>
> (2) [Company CB2], [an Area 1, Country B] limited liability partnership, was a global law firm with offices in [Country B, Region D and Country E]. All of the partners of [Company CB2] were [Country B] professional law corporations. They were the vehicles through which the owners held their interests in [Company CB2].
>
> (3) [Company C (Country U), PC ("Company CC"), formerly known as Company CC1, PC, was a professional corporation incorporated in [Area 2, Country B]. It was admitted a partner of [Company CB2] on 30 November 1995 pursuant to a partnership agreement dated 1 January 1993 ("the Partnership Agreement"), as amended by a subsequent agreement dated 30 November 1995 ("the 1995 Amendment to Partnership Agreement").

(4) The Partnership Agreement contained, inter alia, the following terms:

(a) "Principal Place of Business. The principal place of business of the Partnership shall be in [Area 3, Country B] or such other place as the Managing General Partner may designate." (Clause 2.4)

(b) "Reserve. The Compensation Committee shall determine from time to time in an equitable manner the amount of any moneys required to be paid to the Partnership by, or to be withheld from moneys otherwise distributable to, the Partners, in order to enable the Partnership to conduct its business and to discharge its obligations. The Policy Committee shall specify from time to time in an equitable manner that amount (expressed as a percentage of a Partner's Share of Partnership Net Profits), if any, to be retained by the Partnership for those purposes (the "Reserve"). Each Partner's payments or withholdings, as the case may be, shall be credited to that Partner's Reserve account, unless a Partner elects to pay the same to the Partnership as and when due. The Reserve and any payments or withholdings of a Partner shall be attributed by that Partner to its Members ["Member" being defined as "a shareholder of a Partner" in the Glossary] as determined by the Compensation Committee." (Clause 3.1)

(c) "Draws. On or before the 30th day of each Fiscal Year and upon the admission of a Member during the Fiscal Year, the Compensation Committee shall determine a draw amount attributable to each Member. Within that 30-day period, the Compensation Committee shall notify each Member of the draw amount attributable to that Member and each Partner of the amount that the Partner will be entitled to draw, during the Fiscal Year, against the Partner's Share of Partnership Net Profits for that year, which amount shall be the sum of the draws and related employment taxes attributable to its Members. The draw amounts attributed to Members and payable to Partners may be increased or decreased by the Compensation Committee during the Fiscal Year in accordance with the cash needs of the Partnership." (Clause 3.2)

(d) "Percentages

(a) On or before the 30th day of each Fiscal Year and upon the admission or withdrawal of a Member or a Partner during the Fiscal Year, the Compensation Committee shall determine a percentage amount comprising a portion of 100% which is attributable to each Member (the "Attributed Percentage")

and shall notify each Member of that Member's Attributed Percentage.

(b) The Percentage Interest of a Partner for a Fiscal Year shall be the sum of the Attributed Percentage of its Members. On or before the 30th day of each Fiscal Year, and promptly after the admission or withdrawal of a Member or a Partner, the Compensation Committee shall notify each Partner of that Partner's Percentage Interest. (Clause 3.3)

(e) "Profits and Losses

(a) A Partner shall be entitled during each Fiscal Year to be allocated from Partnership Net Profits for that year the lesser of: (i) an amount in dollars equivalent to the Share of Partnership Net Profits allocated to that Partner with respect to the preceding Fiscal Year or (ii) an amount in dollars determined by multiplying Allocated Profits for the current Fiscal Year by that Partner's Percentage Interest for that year, measured as of year-end.

(b) The Compensation Committee shall determine each Partner's Share of Partnership Net Profits and the amount of each Partner's Share of Partnership Net Profits which is attributable to its Members. The Compensation Committee shall notify each Partner and each Member of such amounts within 15 days after the end of each Fiscal Year.

(c) Each Partner shall bear losses of the Partnership in a Fiscal Year in the proportion that the Percentage Interest of the Partner for that year bears to the Percentage Interests of all Partners for that year, measured as of year-end." (Clause 3.4)

(f) "Clients. All clients for whom any Partner or Member provides legal services shall be clients of the Partnership unless the Policy Committee determines otherwise." (Clause 4.5)

(g) "This Agreement shall be governed by and construed in accordance with the laws of [Area 1, Country B]. The exclusive jurisdiction and venue for any action relating to this Agreement shall be in the Superior Court of [Area 3, Country B]." (Clause 8.7)

(5) The 1995 Amendment to Partnership Agreement contained, inter alia, the following terms:

(a) "Expulsion. Notwithstanding the provisions section 6.4 of the Agreement, the new Partner [Company CC] may be expelled from the Partnership with or without cause, solely by majority vote of the members of the Policy Committee, or its successor, the Partnership, or any successor thereto by amalgation or reorganization, has surrendered, abandoned or otherwise lost its license to practice law in Hong Kong as a foreign law firm or has ceased to maintain an office in Hong Kong". (Clause 2.1)

(b) "Effect of Amendment […] While this Amendment remains in force, the New Partner shall take such steps as may be necessary or appropriate in order to maintain the New Partner's authorization to practice law in Hong Kong, [Area 4 and Area 2 in Country B]." (Clause 3)

(6) [Company CC] was the holding vehicle through which the equity partners of [Company C] Region U offices (including Hong Kong) with Hong Kong qualifications held their interests in [Company CB2].

(7) [Company CD2 (formerly known as Company CD1)] was a partnership established in Hong Kong. It operated as the Hong Kong office of [Company CB2] and had been carrying on a legal practice in Hong Kong. The equity partners of [Company CD2] were individual lawyers practising in Hong Kong and the shareholders of [Company CC]. Clause 2.1 of the [Company CD2] Partnership Agreement dated 1 June 2003 [A/144-149] provided that, "The Partners shall hold their interests in the Partnership in trust for the benefit of [Company CB1], [an Area 1, Country B] limited liability partnership".

(8) By a letter dated 12 March 2003 signed by [Mr G], the then Chairman of [Company CB2] ("the Offer Letter"), [Company CB2] confirmed the terms of the offer extended to the Taxpayer to join the firm as a shareholder commencing 1 June 2003 or on another mutually agreed upon date. (An unsigned version of this letter dated 18 March 2003 with contents largely similar to the one dated 12 March 2003 was subsequently provided by [Ms H], the then Regional Director of Administration of [Company CD2], to the Commissioner of Inland Revenue under cover of a letter dated 26 April 2007) The Offer Letter contained, inter alia, the following terms:

(a) "This letter confirms the terms of the offer extended to you to join the firm as a shareholder beginning June 1, 2003 or on another mutually agreed upon date." (paragraph 1)

(b) "We enclose a Summary of Financial matters which addresses compensation units, monthly draws and capital contributions. Except as noted below, compensation is paid out in the form of monthly fixed draws and a year-end bonus which together equal the total compensation to which you are entitled. From this amount various expenses, including professional expenses, will be deducted." (paragraph 2)

(c) "Your level of compensation will be established each year by the firm's Compensation Committee, based on individual and firm performance. This will be done by allocating to you a specified number of compensation 'units'. The fraction or percentage resulting from dividing your allocated units by the total number of units allocated to all shareholders will establish the portion payable to you of the firm's profits in the applicable year that are made available by the Compensation Committee for distribution to all unit holders. The Compensation Committee also has the prerogative to afford individual bonuses for extraordinary performance in any year." (paragraph 3)

(d) "For 2003, you will receive a pro rata portion of US$1,000,000 (based on the number of days in 2003 that you are part of the firm)… For 2004, you will be placed in a tier with other shareholders and will receive the annual compensation that this tier ultimately receives… Regardless of tier placement, your 2004 compensation will not be less than US$1,000,000. Although historically the firm has usually met or exceeded its budgeted profit (and budgeted point value), there can be no certainty that financial results will meet expectations." (paragraph 4)

(e) "Your monthly draw for 2003 will be [$26,250 in the currency of Country B]. This is consistent with our draw policy; however, if this amount proves to be insufficient, please contact me for further discussion. At [Company CD2], we have defined a full-time schedule as not less than 2,400 hours of service to or on behalf of the firm, inclusive of both billable and non-billable efforts." (paragraph 4)

(f) "From your arrival at [Company CD2], you will make capital contributions in the percentages and in accordance with the terms set forth in the enclosed Summary of Financial Matters. That means that you will contribute 7% of your total income to capital in the firm. In addition, we will expect you to make a catch-up capital contribution to the firm in the aggregate amount of 25% of your first year annual compensation rate [$250,000 in the currency of

Country B]. To facilitate this contribution, [Company CD2] will loan you the necessary funds with interest accruing at the firm's average borrowing rate…" (paragraph 5)

(g) "You will also receive a separate package containing [Company CD2]'s Partnership, Retirement, Employment and Shareholders agreements and their related Glossary. You will be asked to sign each of those documents, as applicable, in their standard forms, something that we require of all of our shareholders. However, this letter will take precedence over our standard forms of Employment and Shareholders agreements to the extent that this letter differs from or adds to those agreements." (paragraph 6)

(h) "When you receive that package, please sign both the shareholder guarantee documents and the duplicate signature pages for the Employment and Shareholders agreements and return them by May 1, 2003..." (paragraph 7)

(9) The Taxpayer also received from [Company CB2], a memorandum dated 20 March 2003 with the caption "Shareholder Documents" as well as a set of documents. At the first paragraph of the memorandum, it is stated that the documents sent to the Taxpayer were "[that is the Taxpayer's] [Company CD1] shareholder documents for [Area 2, Country B] professional corporation", which consisted of : 1. Partnership Agreement; 2. Employment Agreement; 3. Shareholders Agreement; 4. Glossary; and 5. Guaranty.

(10) The Partnership Agreement has been dealt with at paragraphs (4) and (5) above.

(11) In addition to the Partnership Agreement, the Taxpayer also signed a document entitled "Employment Agreement" dated 1 June 2003. This document contained, inter alia, terms as follows:

(a) "Employment and Duties. [Company CC] shall employ Employee to perform, and Employee shall perform, legal services, and such other services as may reasonably be requested by [Company CC].…The precise services of Employee may be extended or curtailed from time to time at the discretion of [Company CC] and shall, in all events, be under the discretion and control of [Company CC]. Employee shall not perform legal services as an employee of, or partner with, any person or entity other than [Company CC]." (Clause 2)

(b) "Full Time Employment. Employee shall devote substantially all of his or her working time to the business of [Company CC]…" (Clause 3.1).

(c) "Base-Salary. For all services rendered by Employee under this Agreement, [Company CC] shall pay to Employee a salary payable from that portion of [Company CC's] draw under the Partnership Agreement which is attributable to Employee, in such amounts and at such times as are determined by [Company CC]." (Clause 4.1).

(d) "Annual Bonus. In addition to the Base Salary, [Company CC] may pay to Employee compensation in the form of an annual bonus ('the Annual Bonus'). The Annual Bonus, if any, shall be paid in December of the Fiscal Year in question, or at such other time as [Company CC] may determine. The amount of the Annual Bonus, if any, and all of its terms and conditions, shall be set by [Company CC] in its discretion [subject to a number of conditions]." (Clause 4.2(a)).

(e) "[….] The Attributed Percentage of Employee is for the purpose of voting on certain matters to be voted upon by the Partners and Members of the Partnership and for the purpose of making calculations under this Agreement but shall not involve or imply any actual allocation to Employee of [Company CC's] interest in [Company CB2]." (Clause 4.2(b)).

(f) "Other Bonuses. [Company CC] may, from time to time, and in its sole discretion, pay to Employee bonus compensation, in addition to the Base Salary and the Annual Bonus." (Clause 4.3).

(g) "Exclusive Basis for Compensation. Employee's compensation shall be determined only as provided in this Agreement and shall not be based upon Employee's holdings of capital stock of the Company." (Clause 4.5).

(h) "Vacations, Leaves of Absence. Employee shall be entitled to reasonable vacation, sabbaticals and leaves of absence for such periods and at such times as might be permitted under [Company CC's] policies or as separately agreed upon by [Company CC] and Employee…" (Clause 6).

(i) "Employee Benefits. Employee shall be entitled to all health insurance and other benefit programs generally available to Members…" (Clause 7).

(j) "Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be delivered by postpaid, first class, registered or certified mail, or by personal or courier delivery or transmission, to Employee at Employee's office at [Company CC] or at his or her residence address on file with the [Company CC], and to [Company CC] at its then-current principal office address in Hong Kong with copy to: [Company CC], c/o [Company CB2], [Address J, County B] …"(Clause 10.2).

(k) "No Entitlement. Employee shall have no direct or indirect interest in [Company CB2] or in [Company CC's] interest in [Company CB2], nor shall Employee have any direct or indirect right, power or entitlement under the Partnership Agreement other than as a Participant in the Retirement System. Employee accepts the stock of [Company CC] and the provisions of this Agreement and the Shareholders Agreement in lieu of, and relinquishes and waives any and all rights, interest or power in [Company CB2] which Employee… has under any prior partnership agreement or might have under law…" (Clause 10.4)

(l) "Governing Law, Consent to Jurisdiction. This Agreement shall be governed by and construed in accordance with the Laws of [Area 2, Country B]. The exclusive jurisdiction and venue for any action relating to this Agreement shall be in the courts of [Area 2, Country B] …." (Clause 10.7)

(m) "Relationship to Partnership Agreement. [Company CC] is a Partner and has no other operations other than its activities as a Partner. As such, it has agreed in the Partnership Agreement to a set of rules and procedures (including the delegation of authority to various committees and officers) that are to govern the management of [Company CB2] and, necessarily, the operations and affairs of [Company CC]…." (Clause 10.9)

(12) In addition to the Partnership Agreement and "Employment Agreement", the Taxpayer also signed a shareholders agreement dated 1 June 2003 ("the Shareholders Agreement"), which contained the following terms:

(a) "Common Stock. [Company CC] shall have issued and outstanding at all times 100,000 shares of Common Stock (the 'Total Shares'). Each shareholder shall acquire and hold that number of shares equal to the product of Total Shares multiplied by his or her Adjusted Attributed Percentage…" (Clause 2.2(a)).

(b) "Preferred Stock. Each Shareholder shall purchase, over time, shares of Preferred Stock at a purchase price of $1.00 per share, as follows: A Shareholder shall pay for the shares through automatic deductions from that Shareholder's Total Compensation…" (Clause 2.3).

(c) "Transfer of Common Stock. Upon termination of a Shareholder's employment by [Company CC], in order to reflect the reduction of that Shareholder's Attributed Percentage to zero, the Shareholder's Common Stock shall be automatically transferred through the transfer process described in Section 2.2 of this Agreement." (Clause 3.1)

(d) "Repurchase of Preferred Stock. Upon termination of a Shareholder's employment by [Company CC], [Company CC] shall repurchase from that Shareholder, and that Shareholder (or the estate of that Shareholder) shall sell to [Company CC], all of that Shareholder's Preferred Stock held on the date of termination." (Clause 3.2)

(e) "Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be delivered by postpaid, first class, registered or certified mail, or by personal or courier delivery or facsimile transmission, to the Shareholder at the Shareholder's office at [Company CC] or at his or her residence address on file with [Company CC], and to [Company CC] at its then-current principal office address in Hong Kong with copy to: [Company CC], c/o [Company CB2], [Address J, Country B]…" (Clause 5.2)

(f) "No Entitlements. No Shareholder shall have any interest, other than as a shareholder, in the capital, assets or earnings of [Company CC], including, without limitation, [Company CC's] interest in [Company CB2]… No Shareholder shall have any direct or indirect interest in the [Company CB2] or in [Company CC's] interest in [Company CB2]. Each Shareholder accepts the stock of [Company CC] and the provisions of this Agreement and the other Basic Documents in lieu of, and relinquishes and waives any and all rights, interest or power in [Company CB2] which that Shareholder… has under any prior partnership or other agreement or might have under law…" (Clause 5.4).

(g) "Governing Law: Consent to jurisdiction. This Agreement shall be governed by and construed in accordance with the laws of [Area 2, Country B] …The exclusive jurisdiction and venue for any action

relating to this Agreement shall be in the courts of [Area 2, Country B]…" (Clause 5.7)

(h) "Relation to Partnership Agreement. [Company CC] is a Partner and has no other operations other than its activities as a Partner. As such, it has agreed in the Partnership Agreement to a set of rules and procedures (including the delegation of authority to various committees and officers) that are to govern the management of [Company CB2] and, necessarily, the operations and affairs of [Company CC]…"(Clause 5.9)

(13) The glossary sets out the terms as defined in the Partnership Agreement, the 1995 Amendment to Partnership Agreement, the Shareholders Agreement, and the Employment Agreement.

(14) The Taxpayer became a partner of [Company CD2] on 1 June 2003. He retired from the partnership on 22 March 2006.

(15) [Company CD2], on behalf of [Company CC], filed an Employer's Return of Remuneration and Pensions in respect of the Taxpayer for the year of assessment 2005/06, which showed, among other things, the following particulars:

(a) Period of employment: 1-4-2005 to 31-3-2006

(b) Capacity in which employed: Equity Partner

(c) "Income received" (with the words "Salary/Wages" as originally appearing on the form deleted, and the words "Income Received" appearing in typescript): $9,155,410 ("Sum A")

(d) Whether paid by an overseas concern: Yes
Name of the overseas company: [Company CC]
Address: [Address K, Country B]

(16) (a) In his Tax Return – Individuals for the year of assessment 2005/06, the Taxpayer declared the following income:

Name of Employer	***Capacity Employed***	***Period***	***Total Amount***
[Company L]	Director	1-4-2005 – 30-3-2006	$50,000

(b) In a letter attached to the Tax Return, the Taxpayer claimed that Sum A was his share of profits received in the capacity of a

shareholder of [Company CC] and therefore was offshore dividend income not chargeable to Hong Kong tax. He also contended that as a partner of [Company CD2], he had already been subject to Hong Kong tax.

(17) The Assessor raised on the Taxpayer the following Salaries Tax Assessment for the year of assessment 2005/06:

Income from [Company CC] [Fact (15)(c)]	$9,155,410
Income from [Company L] [Fact (16)(a)]	$50,000
Assessable Income	$9,205,410
Tax Payable at standard rate	$1,472,865

(18) The Taxpayer objected to the above assessment on the ground that Sum A was offshore dividend income and hence should not be taxable under Salaries Tax.

(19) The Assessor requested the Taxpayer to provide information and evidence to show that Sum A was profit distribution paid to him in his capacity as a shareholder instead of salaries income. In correspondence with the Assessor, the Taxpayer, through CCIF CPA Limited ("the Tax Representative"), put forward the following contentions:

(a) During the year under review, [Company CD2] had incurred a loss and no Profits Tax was payable by it. Nevertheless, the fact remained that as a partner of [Company CD2], the Taxpayer was subject to Hong Kong tax liability for the profits of [Company CD2].

(b) The Taxpayer was a shareholder of [Company CC] until 22 March 2006. [Company CC] was a partner of [Company CB2]. [Company CC] received its entitlement of dividends from [Company CB2] during the year, which had in effect been distributed to its own shareholders including the Taxpayer.

(c) To say that the Taxpayer should be subject to Hong Kong Salaries Tax for his profit distribution, i.e. Sum A, from [Company CC] as well was effectively an attempt to put him subject to tax twice for his role in [Company CB2].

(d) The Taxpayer's shareholding in [Company CC] should correspond to his Attributed Percentage of shareholding at [Company CD2].

His dividend was always in line with his shareholding percentage in that company.

(e) The Taxpayer was not an employee of [Company CC]. He was assigned to [Company CD2] as Chairman of Country U Practice as well as Head of Region V Business Practice. From a legal perspective, [Company CC] had no right to assign its shareholder, the Taxpayer, to work in [Company CD2]. To make it possible, [Company CC] therefore adopted the concept of "employee" for the purpose of designating the Taxpayer to [Company CD2]. [Company CC] did not pay him as an employee. Instead, it rewarded the Taxpayer in his capacity as its shareholder by way of distributions of profits from [Company CB2]. Entitlement to dividend or distribution of profits was a function of shareholding, and not of employment.

(f) The "Employment Agreement" was part of a standard package of contracts that all partners and shareholders of [Company CB2] had to sign. It was purely conceptual to enable the Taxpayer to be assigned to [Company CD2]. It did not create any substantive employment relationship. [Company CC] had no business operations other than being a member of [Company CB2] and as such had not used the services of the Taxpayer. He rendered his services to [Company CB2].

(g) The Taxpayer made a monthly draw against the worldwide earnings of [Company CB2]. The drawings were subsequently set off against the final distribution for the year.

(h) The Taxpayer's monthly drawings of $204,750 were paid through the [Company CD2]'s bank account on behalf of [Company CB2]. It was clearly stated on the pay slip reports that he was a shareholder.

(i) The filing by [Company CD2] of an Employer's Return in respect of the Taxpayer reporting Sum A as his salary for the year of assessment 2005/06 was a mistake made by a newly hired administrator who had no knowledge of the background and partnership structure of [Company CB2]. [Company CB2] had maintained an office in Hong Kong since the early 1990s. The fact that similar filings had not been made in the past demonstrated that the filing in question was an administrative error. As shown in the Employer's Return, Sum A was described as "income received" rather than "salaries/wages". His capacity was also described as an "equity partner".

(j) Payments to the Taxpayer had never been recorded as salaries or expenses in the income statement of [Company CD2]. They were reflected as partners' drawings on its balance sheet.

(20) The Tax Representative provided copies of the following documents:

(a) A letter dated 12 March 2003 issued by [Company CB2] to the Taxpayer with similar content as that.

(b) Pay slip reports for May, June, September, October and November 2005 showing the following:

(i) The Taxpayer's position was a shareholder.

(ii) His job title was Equity Partner.

(iii) His monthly drawings were $204,750.

(21) The Tax Representative stated that as [Company CB2] was dissolved in October 2008 and [Company CD2] had also ceased business, the Taxpayer was unable to furnish further documents to show that [Company CC] had to pay dividend to its shareholders upon the receipt of dividend from [Company CB2].

(22) In reply to the Assessor's enquiries Ms H on behalf of [Company CD2] provided the following information:

(a) [Company CC] had no business operations other than acting as a partner of [Company CB2] and employing the partners of [Company CD2].

(b) The Taxpayer was not a partner in [Company CB2]. He was a shareholder and employee of [Company CC].

(c) The Taxpayer received remuneration from [Company CC] in the aggregate amounts of $4,082,068 ("Sum B") during the period from 1 June 2003 to 31 March 2004 and $9,211,376 ("Sum C") during the period from 1 April 2004 to 31 March 2005. No Employer's Returns were filed for these periods because [Company CC] neither had a business presence in Hong Kong, nor did it meet any Hong Kong tax filing requirements.

(d) The Final Distribution Statements issued for the years 2003 to 2006 were issued by [Company CB2] to the Owners (including the Taxpayer) directly.

(e) The Taxpayer received Sum A, Sum B and Sum C as an employee of [Company CC]. These sums were reflected in the accounts of [Company CC] as salary.

(f) As a privately-held corporation, [Company CC] was not required to prepare or publish financial statements and it did not do so.

(23) (a) [Company CD2] provided December Final Distribution Detail for the years ended 31 December 2003 to 2006 showing the following:

Year	**2003** $*	**2004** $*	**2005** $*	**2006** $*
Compensation	408,342	1,120,000	1,000,000	187,302
Life insurance premium reimbursement	-	1,043	3,606	-
Other income	37,916	65,000	186,658	-
	446,258	1,186,043	1,190,264	187,302
Less: Outside income	(1,282)	(6,410)	-	-
Total distribution	444,976	1,179,633	1,190,264	187,302
Less: Gross draws	(157,628)	(334,397)	(292,511)	(187,302)
Balance of distribution	287,348	845,236	897,753	0
Less: "Required Capital Contribution"	(28,584)	(78,400)	(70,000)	N/A
Net cheque	258,764	766,836	827,753	0
Total Capital Reserve Balance	28,584	356,984	426,984	Nil

* In the currency of Country B.

(b) [Ms H] on behalf of [Company CD2] explained that because of the prevalence of the term "draw" in the legal industry, it was occasionally used within [Company C] to describe amounts paid to its owners. However, despite that causal reference, amounts paid to all owners including the Taxpayer reflected a portion of their budgeted salary for the year and not an actual draw on profits.

(24) The Taxpayer filed Tax Returns – Individuals for the years of assessment 2003/04 and 2004/05 in which he declared employment income of $50,000 received from [Company L] for each of the years.

(25) The Assessor raised on the Taxpayer the following Salaries Tax Assessments for the years of assessment 2003/04 and 2004/05:

Year of Assessment	2003/04	2004/05
	$	$
Income from Company CC [Fact (22)(c)]	4,082,068	9,211,376
Income from Company L [Fact (24)]	50,000	50,000
Assessable Income	4,132,068	9,261,376
Less: Approved charitable donations	(200,500)	(2,000)
Net Income	3,931,568	9,259,376
Tax Payable at standard rate	609,393	1,481,500

(26) The Taxpayer, through the Tax Representative, objected to the Salaries Tax Assessments for the years of assessment 2003/04 and 2004/05 on the following grounds:

(a) The assessments were excessive.

(b) The Taxpayer was a shareholder of [Company CC]. [Company CC] did not pay him as an "employee". Instead, it rewarded him in his capacity as its shareholder by way of distribution of profits upon receipt of its dividend entitlements from [Company CB2]. As Sum B and Sum C were dividend income, they should be exempt from Hong Kong Salaries Tax.

(c) The Taxpayer was a named partner of [Company CD2]. He did not draw any salary from [Company CD2]. During the years under review, [Company CD2] had incurred a loss. Sum B and Sum C were dividend distributed by [Company CC] from the profits of [Company CB2] worldwide operations other than Hong Kong. The income was therefore offshore in nature and non-taxable.

(27) The Assessor set out the facts (as perceived by the Assessor) for the Taxpayer's comments. The Tax Representative, in reply, made the following assertions:

(a) The Taxpayer was an equity partner of [Company CB2] and not a salaried partner. He was a shareholder and director of

[Company CC]. He did not receive employment income from [Company CC].

(b) The Taxpayer's compensation was not paid out in the form of monthly fixed draws and a year-end bonus, which together equalled his total compensation. His monthly draws of [$26,250 in the currency of Country B] were in the nature of advances against the year-end profits distribution of [Company CB2]. The balance of profits distribution was paid directly to him from [Company CB2] but not [Company CC] because he was actually an equity partner of [Company CB2]. As stated in the Offer Letter, his agreed compensation at the time he joined [Company CD2] in 2003 was [$1 million in the currency of Country B] and not [$26,250 in the currency of Country B] x 12. If bonuses were paid, those would be ex-gratia in nature.

(c) [Company CD2] was in no position to provide information on behalf of [Company CC]. The statement in Fact (22)(b) above was not a correct reflection of the Taxpayer's partnership relationship with, and role in, [Company CB2].

(d) The Taxpayer believed that the books of [Company CC] should be kept by [Company CB2], which was dissolved in October 2008. The Taxpayer, despite being a key shareholder and director of [Company CC], had no re-collection of having seen [Company CC]'s books and records.

(e) As mentioned in the Offer Letter, the Offer Letter would take precedence over the standard forms of the "Employment Agreement" and the Shareholders Agreement to the extent that it differed from or added to those agreements. This was a matter where the time-honoured principle of "Substance over Form" should apply.

(f) [Company CB2] referred to its partners as "shareholders" [Fact (8)] in line with its partnership structure whereby partners participated in the firm's business and profits through holding vehicles such as [Company CC]. The Taxpayer, not [Company CC], was invited to join [Company CB2] as a shareholder, i.e. partner. The "package" of documents referred to in the Offer Letter and comprising, inter alia, the "Employment Agreement" was only a matter of form and the substance was as stated in the Offer Letter.

(g) [Company CC] had no business other than its partnership interest in [Company CB2]. There was no substance in the entity to warrant the employment of the Taxpayer and no business in which his efforts and expertise were to be applied. The alleged employment relationship between [Company CC] and the Taxpayer as such defied business sense and the substance of the relationship between him and [Company CB2].

(h) [Company CC] had no health insurance or other Employee Benefit Plans as referred to in Fact (11)(i) above. The Taxpayer participated in [Company CB2's] insurance plans which again reflected the lack of substance of the Employment Agreement.

(i) The Offer Letter was issued by Mr G, Chairman of [Company CB2] who was not related to [Company CC]. The Taxpayer's resignation was to [Company CB2] and not to [Company CC].

(j) The Taxpayer considered the letter dated 12 March 2003 as the correct version of his engagement letter.

(28) The Assessor requested the Taxpayer to provide information including copies of his resignation notice furnished to [Company CB2] [Fact (27)(i)] and settlement agreement entered into with [Company CC] or [Company CB2] upon his retirement from the partnership in March 2006, instruments of transfer of Common Stock and Preferred Stock in [Company CC] [Facts (12)(c) and (d)] as well as the amount of money received on those transactions.

(29) The Taxpayer's travel records during the material time were issued by the Immigration Department. It has subsequently been agreed by the parties that the Taxpayer spent the following number of days in Hong Kong:

Period	Days in Hong Kong
01-06-2003 to 31-03-2004	216 out of 305 (the Taxpayer did not start working for any [Company CD2] entity until 01-06-2003)
01-04-2004 to 31-03-2005	241 out of 365
01-04-2005 to 22-03-2006	257 out of 356 (the Taxpayer ceased working for [Company CD2] on 22-03-2006)

In calculating the above days:

(i) The day of arrival/departure is counted as 0.5 day instead of 1 day.

(ii) If the day of arrival/departure has been included in the previous counting, it is not doubly counted.
(iii) The day-count is inclusive of business days, leave days and weekends when the Taxpayer was in Hong Kong during the period from 1 June 2003 to 22 March 2006.
(iv) The Commissioner of Inland Revenue has not been given any information regarding the Taxpayer's leave days.'

The evidence

11. The Taxpayer gave evidence at the hearing. He had previously submitted two witness statements, one dated 12 November 2011 and a subsequent supplemental witness statement dated 19 December 2011. A summary of the Taxpayer's evidence follows.

12. The Taxpayer is a very experienced and well-known solicitor in Hong Kong. He had previously been an equity partner at Law Firm M for over 20 years. He had and continues to have an extensive corporate finance, commercial and Country U practice. He is an attesting officer of Country U. He holds various public service appointments both in Hong Kong and Country U.

13. His main area of practice includes corporate finance, mergers, acquisitions, joint ventures, and matters related to Country U. He accepted that he had established a very successful practice in the areas of corporate finance, mergers and acquisitions, IPOs and matters related to Country U. He was involved in one of the first listings of a Country U private enterprise in Hong Kong. He was also involved in the reverse takeover listing of the first Country U-controlled listed company in Hong Kong.

14. When the Taxpayer joined Company CD2, he did so with a large team of lawyers from Law Firm M. He acknowledged that when he joined Company CD2, he continued to assist his corporate clients in Country U on raising capital in Hong Kong by listing on the Hong Kong Stock Exchange ('HKSE').

15. Although the Taxpayer asserted that those matters were handled by his associates and partners, it is quite clear that he was involved in the crucial process of obtaining such work and indeed being responsible for dealing with the clients and supervising their files.

16. The Taxpayer acknowledged that his work at Company CD2 often involved arranging cross-border transactions involving Hong Kong. It was clear that the purpose of recruiting him and his team was to expand the scope of Company C's operations in Hong Kong. The nature of his duties was to develop Company CD2's practice as explained in a press announcement. According to that announcement, Company C had decided to grow its Hong Kong office due to very strong interest from its clients to do more business in Hong Kong and in Country U.

17. In his evidence before the Board, the Taxpayer emphasized that before he joined Company CD2, he entered into extensive discussions with Mr G, the Chairman of Company CB2.

18. The Taxpayer asserted that he joined Company CB2 as an equity partner. He noted that at the time he joined, there were about 160 equity partners or shareholders worldwide. At the time he left in 2006, there were about 180 equity partners.

19. He explained that, in becoming an equity partner, he was placed in the '1,000 shareholder units' tier of equity partners.

20. He told us that by translating this ranking into US dollars, it would mean that he was to receive approximately $1 million in the currency of Country B a year, together with the other equity partners who were in the same tier. He confirmed that although he joined on 1 June 2003, he would receive his compensation for 2003 on a pro-rata basis. He also told us that he was obliged to pay various capital contributions and that he had to make a payment to catch up with the other partners. He said that he had received a short term interest free loan for that purpose.

21. The Taxpayer drew our attention to a letter ('the Offer Letter') dated 12 March 2003 which he asserted was an invitation to him from Mr G to become an equity partner of what the Taxpayer called the 'Firm'. It is clear that by the Firm, the Taxpayer meant Company CB2 (that is the entity).

22. The Taxpayer's position was that he was always a partner of the Company CB2 partnership. He described himself as joining Company CB2. He asserted that he was, in substance, a partner of Company CB2 because he contributed capital, received a share of profits, and signed a guarantee. Moreover, he highlighted that he would be considered to be a partner.

23. He emphasized to us that one of the unique features of the Firm was that the senior members were described as shareholders on their name cards rather than partners.

24. He asserted that his true relationship with the Firm was that of a partner and he submitted that we should not give undue weight to the terms that were used in various documents, letters, etc. Instead, he said that we should have regard to what he said was 'the time honoured principle of substance over form'.

25. The Taxpayer relied heavily on the Offer Letter. We have had the opportunity to consider the Offer Letter. This is the letter whereby the Firm extended an offer to the Taxpayer to join as a shareholder beginning 1 June 2003 or on another mutually agreed date. The Offer Letter enclosed a 'Summary of Financial Matters' which dealt with various issues regarding compensation units, monthly draws, etc.

26. In the Offer Letter, the Taxpayer's attention was drawn to the fact that his level of compensation was to be established each year by the Compensation Committee and was to be based on his performance and the Firm's performance. Compensation was allocated through the use of compensation units. In respect of the year 2003, the Taxpayer was to receive a pro-rata portion of $1 million in the currency of Country B based on the number of days in 2003 which he had worked. For 2004, he would be placed in a tier along with other shareholders and would receive the same annual compensation as them. There was an assertion that his compensation for 2004 would not be less than $1 million in the currency of Country B (as mentioned above). In the Offer Letter, the Taxpayer's attention was drawn to the fact that, whilst historically the practice had usually met or exceeded its budgeted profit, there could be no certainty that targeted/expected financial results would be met in the future.

27. The Taxpayer's monthly draw for 2003 was $26,250 in the currency of Country B. He would be making capital contributions in accordance with the percentages and terms set forth in a schedule that was attached to the Offer Letter.

28. The Taxpayer was provided with an interest free loan that was to be repaid over a three-year period. He was also provided with a separate package containing details of Company CD2's Partnership, Retirement, Employment, and Shareholders' Agreements (we refer collectively to the Employment and Shareholders' Agreements as 'Agreements') and the related Glossary. He was asked to sign each of these documents.

29. The Offer Letter provided that 'However, this letter will take precedence over our standard forms of Employment and Shareholders Agreements to the extent that this letter differs from or adds to those agreements'. In the Offer Letter, the Taxpayer was asked to confirm that he had received the package of documents by countersigning and returning the duplicate signature pages.

30. Our attention was drawn to the fact that the Taxpayer signed the following Agreements:

(a) a Partnership Agreement which was subsequently amended;

(b) an Employment Agreement between Company CC and the Taxpayer (this Agreement set out various terms of employment between the Taxpayer and Company CC and the various duties he was required to perform); and

(c) a Shareholders' Agreement between Company CC and himself.

31. The Taxpayer asserted that, based on the explanation given to him by Mr G and having regard to the position he was taking on, he became, in essence, an equity partner or a shareholder of Company CB2. As such, what he received in remuneration was in substance net profits or dividends. In short, the Taxpayer made it clear to us that he was never

receiving any salary. He drew our attention to the fact that he had to sign various guarantees and that he became personally liable for his respective percentage of Company CB2's primary credit agreements with Bank N and Bank P.

32. The Taxpayer stated that, although he received what were called 'monthly draws' in the Summary of Financial Matters, he took the view that these draws were no more than a fixed advance payment on partnership drawings. Again, he reverted back to the Offer Letter which refers to a monthly draw of $26,250 in the currency of Country B for the year 2003.

33. In the course of his evidence, the Taxpayer also tried to clarify what his duties were during his time with the Firm (that is Company CB2). He emphasized that his main task as a shareholder and as Chairman of the Country U practice was to lead Company CB2's global Country U practice; establish its strategy under the guidance of the Policy Committee; and coordinate the work of the lawyers handling work related to Country U around Company CB2.

34. The Taxpayer also stated that he was tasked with building Company C's brand name and profile in Country U. He said that to achieve this task he spoke at countless events and seminars in Country U and visited numerous enterprises and government agencies. In his words, his travel in Country U was 'incessant'.

35. In addition to promoting Company C in Country U, the Taxpayer was also responsible for promoting the Firm's Country U practice to its clients in Country B.

36. The Taxpayer told us that he went to Country B three or four times per year to meet with Company CB2's clients and potential clients in Area 3, Area 5, Area 4, Area 6 and Area 7 for the purpose of promoting the Firm's China practice.

37. The Taxpayer drew our attention to the fact that he carried out various public speaking engagements in Area 4, Area 8, Area 6, Area 5 and Area 7 offices. He asserted that none of these engagements related to Hong Kong matters. Indeed, he told us that when in Country B, he was never asked any questions about Hong Kong.

38. He told us that he was responsible for setting up Company C's City T office in Country U by securing the necessary approvals from the relevant authorities. Again, he asserted that this task was not related to Hong Kong.

39. The Taxpayer stated that he had to originate work for the practice. By that he meant generate work for Company CB2. Some of that work he generated related to anti-trust litigation brought against companies in Country U in Courts of Country B. He testified that he dealt with various matters that were related to Country B's Patriot Act and that he was involved in various high profile litigation cases.

40. As can be seen from the agreed facts, the Taxpayer travelled fairly extensively. But as also can be seen, he did spend a considerable amount of his time in Hong Kong each year.

41. The Taxpayer attempted to assert that Hong Kong and Hong Kong law were not of strategic interest to Company CB2 or indeed to most international law firms. We have to say, however, there is no evidence before us to collaborate the Taxpayer's assertions and show that this was indeed the case. In fact, we note that when the Taxpayer joined Company CD2, he took a substantial number of very experienced Hong Kong qualified lawyers and partners with him and that he set up and ran an extensive practice in Hong Kong during the relevant time.

42. In assessing his evidence, it is clear that when the Taxpayer spoke about the work he was doing outside Hong Kong he did so in rather general terms and he lacked particularity as to exactly what he did and how long each meeting took.

43. The Taxpayer also gave evidence as to the reasons why he left Company CD2. He asserted that when he joined Company CD2 there was an understanding that the three corporate partners from Law Firm M whom he brought with him would be offered equity partnership in due course. This did not happen.

44. The Taxpayer outlined various difficulties which took place when he attempted to have his colleagues promoted to equity partnership. When they remained as salaried partners with no shareholding, various difficulties arose. As a result of those difficulties, he said that he informed Mr G of his decision to retire from the Firm.

45. Although there was no written resignation, the Taxpayer told us that he and his partners, who were formerly with him at Law Firm M, took what he called a collective decision to leave the Firm.

46. Throughout his testimony, the Taxpayer made it clear to us that he was of the view that the Employment Agreement and the Shareholders' Agreement pursuant to which he became a shareholder in Company CC were what he called 'dummy' documentation. In particular, he asserted that all along the Employment Agreement never really had any effect whatsoever.

After the Taxpayer left Company CD2

47. After the Taxpayer left Company CD2, various issues arose with regard to his position and in particular, in regard to the assessments that were raised by the Commissioner. Numerous communications and correspondence later ensued in regard to those issues.

48. There was a letter dated 26 April 2007 to the Commissioner from Ms H who had the title of Regional Director of Administration wherein she stated as follows:

‘ …..

April 26, 2007

Dear Mr Lam,

Thank you for your letter of 17 April 2007.

In response to your inquiry, please note the following:

1. [Mr A] received remuneration in the aggregate amount of HK$9,155,410 for the tax year ended 31 March 2006 from [Company CC], a professional law corporation organized under the laws of [Area 2, Country B]. Its principal place of business is located at [Address K, Country B].

2. [Mr A] received the remuneration described above as an employee of the professional corporation in [Country B].

I attach a copy of [Mr A]’s I.R.56B form for your reference.

I also attach a copy of [Mr A]’s Offer Letter dated 18 March 2003, Employment Agreement dated 1 June 2003, and Shareholder Agreement dated 1 June 2003.

Please do not hesitate to call me at [phone number concealed] if you have any further questions on this matter.

Sincerely,
[Ms H]
Regional Director of Administration’

49. There was then a subsequent letter from Ms H to the Commissioner dated 19 May 2008 whereby she responded to various enquiries. For the sake of completeness, we set out that letter in its entirety:

‘ May 19, 2008

Commissioner of Inland Revenue
Inland Revenue Department
Revenue Tower
5 Gloucester Road
Wan Chai
Hong Kong
Attention: Mr. Lam Wai-Keung

Re: Salaries Tax, Year of Assessments 2005/06
Name of Employee: Mr A
…..

Dear Madam,

I am writing to respond to the inquiries in your letter to our firm dated 19 February 2008.

Overview

[Company CB2], [an Area 1] limited liability partnership, is a global law firm with offices in [Country B, Region D and Country E]. The six partners of [Company CB2] are professional law corporations organized in [Area 9, Area 1, Area 2, Area 10 and Area 6]. The principals of the [Company CB2] law firm (the "[Country B Owner(s)]") are as a technical matter both shareholders and employees of one of the constituent professional law corporations noted. Those shareholder/employees control the operations of [Company CB2] via a voting mechanism with two key attributes: (1) the voting power of any individual is based upon his or her respective annual compensations, and (2) the voting process "passes through" the professional law corporations in order to effect action at the LLP Level.

[Company CD2], a general partnership organized under the laws of the Hong Kong Administrative Region of the Peoples Republic of China, is a related but separate law firm with a single office in Hong Kong. The partners of [Company CD2] are individual lawyers (the "Hong Kong Partners"), each of whom holds a Practising Certificate issued by the Law Society of Hong Kong permitting them to practice as a solicitor of the High Court of Hong Kong. As a technical matter the Hong Kong Partners are also [Country B Owners], i.e., they are both shareholders and employees of one of the corporate partners of [Company CB2], specifically, [Company CC], A Professional Corporation ("the Country U PC").

[Mr A], the subject of your inquiry, was a Hong Kong Partner, a [Country B Owner] and a shareholder/employee of the Country U PC.

Itemized Responses

Set forth below are answers to the specific questions in your letter. For your convenience, note that we have followed the numbering in your letter.

1. We enclose a copy of the certificate of incorporation of the Country U PC (attached as Appendix I).

2. As noted above, [Company CB2] is a limited liability partnership of Country B professional law corporations (each, a "PC," and together, the "PCs"). All of the partners of [Company CB2] are PCs. The PCs are the vehicles through which the [Country B Owners] hold their interests in [Company CB2]. The purpose of the PCs is to limit the potential liabilities of [the Country B Owners]. For example, if [Company CB2] were sued, the actual partners are corporations with limited liability. This helps to shield the individual [Country B Owners] from any personal liability.

3. The Country U PC has no business operations other than acting as a partner of [Company CB2] and employing the Hong Kong Partners.

4. Please refer to paragraph 2 above. As noted, [Mr A] was not a partner in [Company CB2]. From 1 June 2003 to 22 March 2006, he was a shareholder of the Country U PC, which in turn is a partner of [Company CB2].

5. [Mr A] was a partner of [Company CD2]. A copy of the Partnership Agreement is attached as Appendix II.

6. Neither [Company CB2] nor the Country U PC issues Statements of Attributed Percentage. The Attributed Percentage represents a member's compensation level and voting interest in [Company CB2]. It is not synonymous with the percentage of shareholding in a PC. [Mr A]'s attributed percentages for the years 2003, 2004, 2005 and 2006 were 0.685%, 0.591%, 0.58924% and 0.0%, respectively.

7. [Country B Owners] are entitled to vote on those matters set forth in the [Country B] Partnership Agreement. Accordingly, [Mr A] (and each [Country B Owner] in proportion to his or her Attributed Percentage) was able to vote on matters such as the admission of new [Country B Owners], the expulsion of existing [Country B Owners], the election of the governing committee of [Company CB2], the election of the compensation committee of [Company CB2], and the appointment of the Chairman of [Company CB2].

8. [Company CD2] does not issue letters showing amounts of budgeted compensation payable to its partners.

9. [Mr A] received remuneration from the Country U PC in the aggregate amount of HK$4,082,068 from 1 June 2003 to 31 March 2004, and HK$9,211,376.07 from 1 April 2004 to 31 March 2005. No Employers' Return was filed by the Country U PC for this period because that entity neither has a business presence in Hong Kong, nor does it meet any Hong

Kong tax filing requirements.

10. The Final Distribution Statements issued for the years 2003 to 2006 are attached as Appendix III. These were issued by [Company CB2] to the Owners directly.

    Many law firms in [Country B] and elsewhere are partnerships comprised of individual practicing lawyers. Those individuals are generally compensated in the form of partnership "draws" against budgeted profits. Because of the prevalence of the term "draw" in the legal industry, it is occasionally used within [Company C] to describe amounts paid to its [Country B Owners]. However, despite that casual reference, amounts paid to all [Country B Owners] (including [Mr A]) reflect a portion of their budgeted salary for the year, and not an actual draw on profits. As a practical matter, amounts distributed during the course of the year have never had to be refunded due to a budget shortfall.

11. After a search of [Company CB2] and [Company C]'s files, neither an offer letter dated 12 March 2003 or a signed version of the 18 March 2003 offer letter was found. We consider the 18 March 2003 (unsigned) offer letter to be the correct version.

12. (a) Inasmuch as we have not been provided the pay slip reports submitted by [Mr A]'s representative, we cannot confirm whether the amounts stated in the pay slip reports are the same as that reported in the Employer's Return (IR56B).

    (b) With respect to the use of the term "drawings" in the subject reports, we are again unable to comment since we have not been provided copies of the documents filed by [Mr A]. However, we can say that in our internal recordkeeping, [Country B] Owners are referred to as "Shareholders" to reflect their status within the organization.

13. Income paid to [Mr A] was reflected in the accounts of the Country U PC as salary. As a privately-held corporation, the Country U PC is not required to prepare or publish financial statements and it does not do so.

Please do not hesitate to call me at [phone number concealed] if you have any further questions on this matter.

Sincerely,
[Ms H]
Regional Director of Administration"

50. As can be seen, various documents were attached to that letter.

51. On 17 December 2008, Ms H sent another letter to the Commissioner. We set out the contents of that letter in its entirety as follows:

> ' December 17, 2008
>
> The Commissioner of Inland Revenue
> G.P.O. Box 132
> Hong Kong
>
> Dear Madam:
>
> We refer to the Department's letters dated 31 October 2008 and 3 December 2008 (approving our request for an extension of time to furnish the information requested).
>
> Concerning your questions:
>
> 1. [Mr A]'s income for each year ended 31 March 2004 and 2005 was paid in his capacity as an employee of [Company CC].
>
> 2. Please be advised that [Company CB2 in Country B] is currently in dissolution. In addition, the Hong Kong partnership, [Company CD2], has ceased its practice as of the beginning of December. As such, access to financial information concerning Shareholders who previously left the firm is difficult to obtain. We have searched our payroll files, both in Hong Kong and [Country B], for [Mr A]'s remuneration for the years ended 31 March of 2004 and 2005. We attach the best records we can find given the circumstances of the firm. They include:
>
>   - December Final Distribution Detail dated December 31, 2003
>   - December Final Distribution Detail dated December 31, 2004
>   - Revised December Final Distribution Detail dated December 31, 2005
>   - Spreadsheet showing amounts paid in Hong Kong for tax years 2003/2004 and 2004/2005.
>
> Please note that effective 1 December 2008, [Law Firm Q's] is handling the business matters of [Company CD2]. If you have additional questions, please contact [an employee from Law Firm Q].

> Finally, we understand that [Company CD2] is required to notify the IRD that the partnership has ceased doing business in Hong Kong. Appropriate notification will be given in due course.
>
> Regards,
> [Ms H]
> Director of Administration
> [Company CD2] (Ceased Practice)"

52. We note that [Company CB2] faced various financial difficulties and was dissolved at the end of 2008 under the Bankruptcy law in Country B.

The Taxpayer's Response to the Letters and his Position

53. In his evidence before us, the Taxpayer obviously took issue with the letters written by Ms H to the Commissioner. He asserted that she had no authority to write those letters. According to the Taxpayer, Ms H never knew what was going on in the partnership and was not privy to any of the negotiations which he had with Mr G. Specifically, he further asserted that it was unlikely that Ms H had any knowledge or dealings with what he called the Firm's complex partnership/shareholding structure.

54. He asserted that all partnership matters were handled by Mr R, Director of Partner Recruitment and Benefits, and her team out of Area 3, Country B.

55. In short, the Taxpayer's evidence was that all along none of the monies which he received were what he called 'salaries'. In his view, the Employment Agreement with Company CC was nothing but a sham or what he called a 'dummy document'. He submitted that the Board should look at the substance of matters not at the Agreements or the letters that were written by Ms H in regard to the various returns that were filed with the Commissioner.

56. The Taxpayer repeated time and time again that he took the view that he was always an equity partner or a Country B owner in Country B practice. As such, any monies which he received were the result of a distribution of profits or dividends in accordance with the agreement he reached with Mr G.

57. However, with respect, there was no evidence before us other than the Taxpayer's bare assertion that this was indeed the case. The Taxpayer did not call any evidence from any of the past 'partners' or his fellow shareholders in Company CB2, nor did he adduce any evidence to corroborate or support what he was saying.

58. In his witness statement, the Taxpayer stated '….. [Company CC] is a corporate or legal entity "without a mind"; it is a mere dummy …..'. There was no evidence, however, to support such contention. His assertion that '[T]hus, these six so called [Company C] partners are all dummies and necessarily, only the individual members (that is

the real equity partners, such as myself and [Mr G]) were thus the actual owners or ['Country B Owners'] of the Firm and it was only they who were to run and manage the Firm business within the management framework as set out in the Partnership Agreement' was never made out or supported by any evidence that was before the Board.

59. The Taxpayer also drew our attention to the fact that in 2010 he came to terms with the Official Committee of Unsecured Creditors of Company CB2 ('the Committee') in respect of various payments he had received during his position as a corporate general partner. In essence, the Committee was of the view that certain payments which he had received constituted 'fraudulent conveyances'. The Taxpayer said that a settlement had been reached which required him to make a payment of $18,659 in the currency of Country B. Again, he asserted that this was indicative of him being in essence a partner/shareholder of Company CB2.

60. He asserted again and again that at no time was there any employment relationship whatsoever between himself and Company CC.

61. It became clear to us during the course of the Taxpayer's evidence that the position taken by him meant that, unless he was able to show that the Employment Agreement with Company CC was in fact a 'dummy' contract, he would have great difficulty in convincing us that his argument as to the nature of his relationship with Company CB2 was correct.

The charging provisions for salaries tax

62. The relevant provisions in the IRO are set out below.

63. Section 8 sets out the charging provision for Salaries Tax and states as follows:

> ' *(1) 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 …..'*

64. Section 9 provides an expansive definition of '*income from any office or employment*'. Section 9(1)(a) states as follows:

> ' *any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others …..'*

65. The charging provision in section 8(1) is also extended by section 8(1A) which provides as follows:

'*(1A) 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.

(1B) In determining whether or not all services are rendered outside Hong Kong for the purposes of subsection (1A) 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.'

66. In regard to the foregoing sections, we accept the submission of Ms Cheng that it is well-settled that:

(a) where a source of income is fundamentally a Hong Kong employment, all income from that source is charged under section 8(1), irrespective of where the services were actually rendered (we note that there are certain exceptions in that section which in our view are not relevant on the facts of this case); and

(b) even where a source of income is fundamentally an employment outside Hong Kong, the income generated from services rendered in Hong Kong will be charged under section 8(1A)(a), save for income covered by the

'60-day rule' in section 8(1B).

67. In particular, we refer to CIR v Goepfert (1987) 2 HKTC 210. As held therein, in determining the locality of a taxpayer's employment, the Board has to consider 'where the income really comes to the employee'. Notwithstanding that decision, we are not precluded from applying the 'totality of facts' test in considering the locality of a taxpayer's employment.

Discussion

68. As stated at the outset of this decision, the primary issue is whether the Sums (that is the income received by the Taxpayer) were income from employment within the meaning of section 8 of the IRO. As can be seen, the Taxpayer claimed that his income was not income from any employment with Company CC, but instead was a distribution from Company CB2 (that is the Country B partnership). Moreover, as also can be seen from the various submissions that were put to us by Ms Lui, there was also an assertion that even if there was an employment relationship between the Taxpayer and Company CC, it was a non-Hong Kong employment.

69. In reply, the Commissioner accepted that, whilst there were elements of the relationship between the Taxpayer and Company CD2 that attempted to mimic features of a partnership, the legal framework used by the parties was such that the Taxpayer was an employee and shareholder of Company CC. Moreover, the Commissioner (through Ms Cheng) argues that there is no basis for us to ignore what is in black and white – that is the legal reality of the situation. In those circumstances, she concluded that the Sums were paid to the Taxpayer in his capacity as an employee of Company CC.

70. In arriving at our decision, we have not only considered very carefully the skeleton arguments put to us by both Ms Lui and Ms Cheng, we also listened very carefully to their respective submissions and reviewed all the authorities that were put to us in respect of this matter.

71. Before we embark upon our analysis and discussion, we do need to remind ourselves that the burden of proof on showing that the Assessments are excessive or incorrect lies solely on the Taxpayer (section 68(4) of the IRO).

72. It is therefore for the Taxpayer to establish why his income does not fall within section 8(1) of the IRO rather than for the Commissioner to prove a case.

Taxpayer was an employee of Company CC

73. It is quite clear that the Taxpayer was asking the Board to look at the substance as opposed to the form of his relationship with Company CD2 and to conclude that the various Agreements which he signed were in essence 'dummy contracts' and that the various corporations were 'dummy corporations'. This contention does not find favour with us and

is devoid of merit. In our view, the Taxpayers' use of the terms 'dummy contract' and 'dummy corporation' were inappropriate and were never supported by any evidence before the Board. The Taxpayer's contention was a bald assertion without regard to reality. Hence, we have no hesitation in rejecting this part of the Taxpayer's evidence.

74. It is also quite clear that the Taxpayer had the opportunity to adduce evidence before us to support the contentions he was putting forward including the nature of his relationship with Company CD2 and the veracity and correctness of Ms H's letters, but that he failed to do so.

75. Having regard to all of the evidence before us, we come to the conclusion that, as a matter of fact, the Taxpayer was an employee of Company CC. The Employment Agreement was signed by the Taxpayer and it is quite clear from the terms of that agreement that the Taxpayer and Company CC chose to establish an employee-employer relationship. Indeed, the preamble of the Employment Agreement talks about the Taxpayer's employment with Company CC.

76. Further support for our conclusion that there was an employer-employee relationship can be found in:

- clause 2 which states:

> ' The Company [Company CC] shall employ Employee [the Taxpayer] to perform, and Employee shall perform, legal services, and such other services as may reasonably be requested by the Company. ….. Employee shall not perform legal services as an employee of, or partner with, any person or entity other than the Company …..';
>
> - clause 3.1 which states:
>
> ' Full Time Employment. Employee shall devote substantially all of his or her working time to the business of the Company …..'; and

- clauses 4.1 and 4.2 which provide for the payment of salary and bonus.

77. The Taxpayer's assertion that he was required to dedicate his full attention to Company CC did not make sense because he was in essence working for Company CD2. Nevertheless, we accept that the business of Company CC was to establish a Hong Kong legal practice and that this turned out to be Company CD2.

78. The documents that were put before the Board, in particular Ms H's letters dated 26 April 2007, 19 May 2008 and 17 December 2008, which we have already set out in full above, were unequivocal.

79. We reject Ms Lui's submissions on behalf of the Taxpayer that Company CD2 was not in a position to answer questions on behalf of Company CC. Ms H was not merely some junior clerk, but was the 'Regional Director of Administration'. She was responsible for looking after the offices in Hong Kong, Country S, and City T, Country U. As such, the Ms Lui's submission could not be made out.

80. Moreover, there was no basis for trying to suggest that Ms H did not have the requisite authority and knowledge to write the letters. Indeed, as Ms Cheng points out, the Taxpayer could never make out his assertion that Ms H was not in a position to answer questions on behalf of Company CC because the Taxpayer had left Company CD2 over a year before the Company CD2 replies were sent to the Commissioner.

81. The Commissioner provided the Taxpayer's representatives with all relevant documents and letters. It was clear that neither the Taxpayer nor CCIF provided any substantive comments to the Commissioner notwithstanding his request for answers to various questions. Indeed, during the course of his evidence, the Taxpayer asserted that, given his busy travel and work schedule, fault lies with him in not responding to the Commissioner's attempts to obtain information. This is not an excuse which we are prepared to accept. No evidence other than the Taxpayer's own bald assertions was put before the Board to establish that what Ms H stated in her letters was incorrect.

82. We have also considered the evidence that was before us showing that Company CC filed employer's returns for the relevant years in respect of monies received by the Taxpayer, in particular year 2005/06. For the Taxpayer to assert that this was possibly a mistake or alternatively a change of policy on the part of Company CC or the Firm is something which is mere speculation.

83. In regard to the employer's returns, we repeat what we have stated above: no witnesses were ever called before the Board to explain how and why the employer's returns were incorrect.

84. In Ms Lui's submissions she asserted that in the relevant returns, income was stated as 'income received' rather than salary/wages. In this regard, however, we accept Ms Cheng's submission that such description is not indicative of anything. We accept that one must have regard to the context in which the document was filed. It was a tax return filed by an employer reporting remuneration paid to its employees. This is an incontrovertible fact. No evidence was adduced by the Taxpayer to show that the tax return was filed incorrectly and no satisfactory explanation was given to us.

85. We conclude that the Employment Agreement was straightforward and we accept it as reflecting the true nature of the relationship between the parties.

Taxpayer was not a partner of Company CB2

86. Much of the evidence that the Taxpayer put before us was for the purpose of asserting he was not an employee of Company CC, but instead a partner of Company CB2.

87. We have had the opportunity to carefully consider all of the relevant documents before us and the submissions of both counsel. On our analysis, we accept Ms Cheng's submission that the Taxpayer's assertion that he was a partner of Company CB2 cannot stand up to scrutiny. Hence, we reject it.

88. In coming to this conclusion, we note that there was never any partnership agreement put before us between the purported individual partners of Company CB2. If the Taxpayer was a partner of Company CB2, one would have expected there to be a document to that effect. The partnership agreement, which we had sight of, shows that Company CC was a corporate partner of Company CB2. The Taxpayer was never a partner to that partnership agreement. It is clear that Company CC (as opposed to the Taxpayer) was a partner of Company CB2 and indeed this was acknowledged by the Taxpayer during his interview with the IRD on 22 April 2009.

89. We accept that for a partnership to exist there must be a relationship between the partners. Ms Cheng referred us to section 3 of the Partnership Ordinance and Lindley & Banks on Partnership. In order for one to be a partner of a partnership, one needs to enter into an agreement with the other partners. In the case before us, there was no such relationship between the Taxpayer and partners of Company CB2.

90. Of course, in the case of Company CD2, everyone talked colloquially about the partners of a firm. It is the partners who themselves comprised the firm. Therefore, a person can only join a firm as a partner by agreeing with each and every one. The Taxpayer of course does not obtain any assistance from citing the law on partnership without identifying in the present case any facts to show there was a partnership agreement with the other partners of Company CB2.

91. There was an attempt by the Taxpayer to rely on the Offer Letter to suggest that in substance he must have been a partner of Company CB2. This was never made out and indeed no evidence was called to support his assertion that this was the case.

92. Our attention was also drawn to Ross v Parkyns (1875) LR 20 Eq 331, Stekel v Ellice [1973] 1 WLR 191; Kao, Lee & Yip v Edwards [1994] 1 HKLR 232; and Young v Zahid [2006] 1 WLR 2562.

93. Those cases explain what needs to be established for a partnership to exist. We accept Ms Cheng's submission that those cases can be contrasted with the case before us by virtue of the fact that Company CC is a partner of Company CB2 and it entered into a partnership agreement with other corporate partners of Company CB2.

94. There was the partnership agreement entered into between the Taxpayer and the other partners of Company CD2, but there was no agreement which the Taxpayer could point to which could give rise to him being a partner of Company CB2.

95. In coming to our conclusion that the Taxpayer was not a partner of Company CB2, we have also analyzed the Shareholders' Agreement. The terms of the Shareholders' Agreement show quite clearly that the Taxpayer was not a partner in Company CB2. In particular, we refer to Clause 5.4:

> ' ….. No Shareholder shall have any direct or indirect interest in the Partnership or in the Company's interest in the Partnership. Each Shareholder accepts the stock of the Company and the provisions of this Agreement and the other Basic Documents in lieu of, and relinquishes and waives any and all rights, interest or power in the Partnership which that Shareholder ….. has under any prior partnership or other agreement or might have under law, including without limitation, the right to receive any payment for goodwill, the right to receive interest on any Partnership account balance, the right to demand an accounting of any Partnership business or an interest in the Partnership capital, assets or earnings, or the right to demand an interest in or access to Partnership files, records or clientele, existing at the time of death, disability, withdrawal, expulsion, dissolution, merger or retirement.' [emphasis added]

96. We accept Ms Cheng's submission that the Taxpayer could never have been a partner of Company CB2 because he had no rights or obligations vis-à-vis the other partners and indeed the whole point of the Shareholders' Agreement and the Employment Agreement was to create a relationship whereby the Taxpayer was not a partner of Company CB2.

97. We also note that each of the Shareholders' Agreement, Employment Agreement and Partnership Agreement had entire agreement clauses. Thus, when considering the relationships amongst the parties, one simply has to look at the form of each of those agreements. Of course, one of the reasons for this structure was to limit the potential liabilities of the individual lawyers.

98. The proposition put forth not only by Ms Lui, but also by the Tax Representative in its correspondence, was that the Taxpayer had no choice in the structure of the Firm and that he was obliged to sign the Shareholders' Agreement and the Employment Agreement as part of the standard package for new joiners.

99. Indeed, the Taxpayer said in his own statement before the Board that he had to accept the existing system of ownership and governance of Company CD2. Accordingly, there was no way in which the Taxpayer could become a partner in Company CB2. Once again, the Taxpayer placed great reliance on the Offer Letter. But in our view, as stated above, this does not change anything. The Taxpayer himself noted that the offer was for him to join as a shareholder. He was welcomed on that basis. The Offer Letter therefore did not detract from the terms of the Shareholders' Agreement or the Employment Agreement.

100. The Taxpayer also claimed that he made capital contributions to Company CB2. There was simply no evidence, however, to suggest that any payments made by him were a contribution to the capital of the Firm in his capacity as a partner. There was no provision in the Company CB2 Partnership Agreement for the payment of capital by persons such as the Taxpayer who, as we have previously pointed out, were never parties to that agreement.

101. The Taxpayer again asserted that his obligations arose from the Offer Letter. But clearly the Offer Letter was not a contractual document.

102. We are of the view that the payments made by the Taxpayer were for the acquisition of Preferred Stock under the Shareholders' Agreement. Perhaps this would explain why he received a refund from Company CC rather than Company CB2.

103. The Taxpayer's contention that he received a share of profits from Company CB2 was really nothing but a bald assertion. There was no evidence before us to support that assertion. We also note that there were no accounts showing what the Company CB2 partnership earned and how the Taxpayer's 'share' was calculated.

104. When cross-examined by Ms Cheng as to the legal basis on which he could claim a share of profits from Company CB2, the Taxpayer could only point to the Offer Letter. Again, as we have found above, the Offer Letter has no legal basis other than enclosing the various legal documents which the Taxpayer was asked to sign.

105. In his evidence, the Taxpayer asserted that he signed a guarantee in regard to various banking obligations. However, no signed copy of this document was provided to the Commissioner. Indeed, in the Offer Letter, the Taxpayer was in fact only asked to sign the Employment Agreement and the Shareholders' Agreement and not the Guarantee.

106. We accept Ms Cheng's submission that there is no evidence before us to establish that the Taxpayer signed the Guarantee. In cross-examination, the Taxpayer acknowledged that he might not have signed the Guarantee. Notwithstanding the Taxpayer's claim that the litigation brought by Bank N and Bank P demonstrated that he must have signed the Guarantee, there was no evidence to support his assertion that this was indeed the case. It appears that the settlement which he entered into was a means of obtaining a mutual release in respect of various claims against the Taxpayer in his capacity as a shareholder rather than as a guarantor. Again, the burden of proof was upon the Taxpayer to show that he did sign the Guarantee.

107. It is also incontrovertible that the Taxpayer was held out as a shareholder by Company CD2 rather than as a partner. Indeed, if one had regard to the Taxpayer's business cards, he was described as a shareholder. Moreover, by his own admission, the Taxpayer testified that a significant difference between Company CB2 and other large Country B firms was the fact that the senior lawyers were considered to be shareholders rather than partners.

108. It is quite clear to us that Company C was intentionally structured so that the Taxpayer and his peers (both in Hong Kong and overseas) would not be partners of Company CB2. In this way they could be shielded from liability.

109. Instead the partners of Company CB2 were corporate partners such as Company CC. The Taxpayer and his peers were in turn the shareholders and employees of those corporate partners.

110. Company CC was the corporate partner in Company CB2 through which Company C extended its operations into Hong Kong and Country U, and furthermore Company CC was the entity which shielded the Taxpayer and his Hong Kong based peers from potential liability. In those circumstances, it can hardly be said that Company CC was a 'dummy corporation' and again we reject that assertion.

Substance versus Form

111. During the course of argument, there were extensive discussions regarding the topic of 'substance over form'. Assertions were made by the Taxpayer and Ms Lui that the Shareholders' Agreement and the Employment Agreement were artificial or indeed fictitious documents. Moreover, it was asserted by the Taxpayer and his counsel that we should brush aside the Employment Agreement and the Shareholders' Agreement because of the so called 'time-honoured principle of substance over form'. As we have said above, there were no facts or law put before us to support the Taxpayer's assertion that we should brush aside those Agreements.

112. Whilst the Board is not bound by mere labels (for example, the fact that the Employment Agreement is described as such is not in itself conclusive of the Taxpayer's status of an employee), we cannot simply ignore legal agreements which were entered into between the Taxpayer and Company CC in circumstances where there was no evidence whatsoever to support the assertion that the Agreements were of no legal effect.

113. In support of her argument that the Agreements should not be ignored, Ms Cheng referred us to the following comments of Lord Herschell LC in McEntire v Crossley Bros Ltd [1895] AC 457 at 462-3:

> ' *Coming then to the examination of the agreement, I quite concede that the agreement must be regarded as a whole – its substance must be looked at. The parties cannot, by the insertion of any mere words, defeat the effect of the transaction as appearing from the whole of the agreement into which they have entered. If the words in one part of it point in one direction and the words in another part in another direction, you must look at the agreement as a whole and see what its substantial effect is. But there is no such thing, as seems to have been argued here, as looking at the substance, apart from*

> *looking at the language which the parties have used. It is only by a study of the whole language that the substance can be ascertained'; and*

the comments of Lord Watson at page 467 in the same case:

> *' ….. it must always be borne in mind that the substance of the agreement must ultimately be found in the language of the contract itself. The duty of a Court is to examine every part of the agreement, every stipulation which it contains, and to consider their mutual bearing upon each other; but it is entirely beyond the function of a Court to discard the plain meaning of any term in the agreement unless there can be found within its four corners other language and other stipulations which necessarily deprive such term of its primary significance.'*

114. Ms Cheng also drew our attention to IRC v Duke of Westminster [1936] AC 1 where Lord Tomlin said at page 19 as follows:

> *'….. it is said that in revenue cases there is a doctrine that the Court may ignore the legal position and regard what is called "the substance of the matter"….. This supposed doctrine ….. seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled, and the supposed doctrine given its quietus, the better it will be for all concerned, for the doctrine seems to involve substituting the incertain and crooked cord of discretion" for "the golden and streight metwand of the law".'*

115. Finally our attention was also drawn to NZI Bank Ltd v Euro-National Corporation Ltd [1992] 3 NZLR 528 where Richardson J stated the following at page 539:

> *' The legal principles are well settled. First the true nature of a transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out. It is not to be determined by an assessment of the broad substance of the transaction measured by the overall economic consequences to the participants. The forms adopted cannot be dismissed as mere machinery for effecting other purposes. At common law there is no half-way house between sham and characterisation of the transaction according to the true nature of the legal arrangements actually entered into and carried out. A document may be brushed aside if and to the extent that it is a sham in two situations. The first is where the document does not reflect the true agreement between the parties in which case the cloak is removed and recognition is given to their common intentions. The second is where the document was bona fide in inception but the parties have departed from their initial agreement while leaving the original documentation to stand unaltered. Once it is established that a transaction is not a sham its legal effect will be respected.'*

116. We agree with the arguments of Ms Cheng and in this regard take comfort in the judgment of Bokhary PJ in Kwong Mile Services Ltd v CIR (2004) 7 HKCFAR 275 at paragraph 9 where he said the following:

> '*Judging the matter of source as one of practical reality does not involve disregarding the accurate legal analysis of transactions.*'

117. In that case, His Lordship went on to cite Esquire Nominees Ltd v FCT (1973) 129 CLR 177 where Gibbs J stated:

> *' We are frequently told ….. that such a question is "a hard, practical matter of fact". ….. But it does not mean that the question is one for a jury or that it is one for economists set free to disregard every legal relation and penetrate into the recesses of the causation of financial results, nor does it mean that the court is to treat contracts, agreements and other acts, matters and things existing in the law as having no legal significance.*'

118. As Ms Cheng pointed out, it was quite clear that if the Taxpayer wished to join Company CB2 then he had to sign the Agreements. The Agreements served the purpose of providing individuals with protection from liability (as stated above) and were far from being false or 'dummy' documents. We find that the Agreements were intended to be legally binding as was submitted by Ms Cheng.

119. In a further and final effort to support his contention that the Employment Agreement should be disregarded, the Taxpayer submitted that the Employment Agreement was a 'fiction' because the directors of Company CC never discussed and determined the Taxpayer's 'fictional' salary. This argument, however, ignores the fact that, as per Clause 4 of the Employment Agreement, Company CC was to determine the Taxpayer's salary and, as per Clause 10 of that agreement, various actions of Company CC including compensation matters would be determined by the Compensation Committee of Company C and adopted by Company CC without the need for specific action by its directors.

120. Accordingly, there would not have been any need for Company CC's directors to have held any such discussions. We accept Ms Cheng's submission that there was nothing fictional about Clause 4 of the Employment Agreement and indeed the Taxpayer accepted this in cross-examination.

121. In conclusion, we conclude that there is no room either in law or in fact for the Taxpayer to argue that he was in substance a partner of Company CB2 and that the Agreements should be ignored as being merely 'artificial', 'fictional', 'archaic', or 'dummy' documents which served no purpose.

Control

122. We take the view that matters such as 'control' are of little relevance in the present case and that it is not enough for the Taxpayer to argue that there are factors which suggest that he is not acting like an employee. Moreover, the various authorities cited by the Taxpayer's representative regarding the issue of whether a person is an employee or an independent contractor were all decided in very different legal contexts (frequently in the context of personal injury claims) and were distinguishable on the facts.

123. If the Taxpayer was not an employee, then in what capacity did he receive his income? This rhetorical question takes us back to the fundamental question of whether or not the Taxpayer was a partner of Company CB2. As we have concluded above, the Taxpayer was clearly not a partner of Company CB2. Therefore, the only obvious source of his income must have been through his employment with Company CC, regardless of whether or not he was under the 'control' (in the manner in which that word is used in the cases relied upon by Ms Lui) of his employer. In a case such as this, where the Taxpayer is a very senior lawyer, traditional tests of 'control' (as Ms Cheng points out) are unhelpful since obviously such professionals may not be under anyone's 'control'. Nonetheless they may still very well be employees.

The Taxpayer did not receive dividends

124. There was no evidence before us to show that the Taxpayer received his remuneration as dividends from his shareholding in Company CC. Again, as we have found, the Taxpayer was not a partner of Company CB2 and he had no entitlement to ask the partners of Company CB2 for any amount. Merely asserting that the Sums were remitted to him by Company CB2 does not answer or deal with the question of how these payments were actually made.

125. In previous communications and correspondence between the Taxpayer and the IRD, the Taxpayer tried to argue that the income was dividend income from his shareholding in Company CC. In particular, we refer to his letter of 27 December 2006. Again, this argument cannot be made out. It is also clear that the Taxpayer's shareholding in Company CC was merely an incidence of his employment.

126. There was no provision under the Shareholders' Agreement for the payment of dividends or any Common or Preferred Stock and furthermore there was no evidence whatsoever before us to show that Company CC could declare dividends as a matter of corporate law. We note that no board resolutions were provided to us to show that dividends had been declared. It is quite clear that if dividends were paid, they could not be paid out of capital. They must be paid out of income. It is not for the Board to speculate whether or not dividends were paid by Company CC or any other party.

127. In all of the circumstances, we reject the Taxpayer's submission that the Sums were dividend income from his shareholding in Company CC. Indeed, one also has to have

regard to the Taxpayer's assertion that Company CC was a 'dummy corporation'. If that was the case, how can the Taxpayer assert that dividends could have been declared by it?

128. It is quite clear (as concluded above) that the Employment Agreement shows that the Taxpayer's employment with Company CC was his source of such income. The terms of the Employment Agreement illustrate that the Taxpayer had to work full time for Company CC, in return for which he would be remunerated. Indeed, there were confirmations both by Company CC and Company CD2 that the Sums were remuneration from his employment.

Conclusion on the primary issue

129. The Taxpayer has not established that the Sums were not income from an employment. Furthermore we have no hesitation in concluding that the Sums which were received by the Taxpayer were derived from Clauses 4.1 and 4.2 of the Employment Agreement between Company CC and the Taxpayer, and thus were income from an employment. Those clauses provided that Company CC would pay the Taxpayer a salary from Company CC's partnership drawings under the Company CB2 Partnership Agreement and a discretionary bonus.

The secondary issue – Hong Kong employment

130. As mentioned at the outset of this decision, a secondary issue in this appeal was whether or not the Taxpayer's employment (if we were to find that an employment relationship existed between the Taxpayer and Company CC) was a Hong Kong employment. This issue arose from the final ground of the Taxpayer's appeal, which was amended at the hearing with the consent of the Commissioner.

131. We would be remiss if we did not say that this ground was not vigorously argued by the Taxpayer and that it seemed to be somewhat of an afterthought.

132. We wish to emphasize that that the burden of establishing that the Taxpayer's employment with Company CC was not a Hong Kong employment is on the Taxpayer himself.

133. Although the Employment Agreement was governed by the law of Area 2, Country B and is enforceable in that jurisdiction, this fact does not carry much weight in view of the fact that the Taxpayer's own case was that the choice of law/jurisdiction clause was a standard term.

134. More importantly, one has to have regard to the fact that the Taxpayer was recruited in Hong Kong and he and his team were brought in to expand Company C's operations in Hong Kong. Indeed, having regard to the evidence he gave before the Board as to how he moved his team into Company CD2 and having regard to CCIF's letter of 18 July 2007, the purpose of Company CC assigning the Taxpayer to Hong Kong, was to

head the Country U and Region V Practice.

135. The Taxpayer's duties, as we have said above, were to develop that practice. In this regard, we refer to the press announcement which clearly concluded that Company C had decided to grow its Hong Kong office because there was a very strong interest from its clients to do business in Hong Kong and Country U.

136. One also has to have regard to the fact that the Agreements provided that Company CC was to maintain a principal office in Hong Kong. The offer of employment was also made to the Taxpayer in Hong Kong and throughout the Taxpayer's employment he was paid in Hong Kong.

137. In the Taxpayer's opening submissions, there was an assertion that the Taxpayer's work had no direct relationship with Hong Kong. We do not accept this assertion and we find as a fact that a significant portion of the Taxpayer's work did have a direct relationship with Hong Kong, particularly in regard to the listing of Country U enterprises on the HKSE and other corporate law services. As we previously noted above, the Taxpayer had established a very successful legal practice in Hong Kong and indeed, he was one of the leading lawyers in the fields of corporate finance, mergers and acquisitions, and IPOs. CCIF's letter of 18 July 2007 clearly stated that the Taxpayer moved to Company CD2 (that is with his team of Hong Kong qualified lawyers) for the purpose of heading the Country U and Region V Business Practice of Company C.

138. Nevertheless, even if the Taxpayer's work had no direct relationship with Hong Kong (which we do not accept), this assertion cannot be relevant, as many foreign lawyers working in Hong Kong may be advising clients about foreign laws and this does not mean that they do not have a Hong Kong employment.

139. There was sufficient evidence that the Taxpayer spent a considerable amount of his time in Hong Kong advising clients on Hong Kong law and supervising work that was done for clients that were previously with his old firm and who followed him and his team to Company CD2. The fact that the Taxpayer travelled extensively is in our view neither here nor there. Indeed, this does not detract from Ms Cheng's submission that Hong Kong was the hub of Company CC's operations. We entirely agree with her.

140. One must also have regard to the actual number of days that the Taxpayer spent in Hong Kong. Indeed, the agreed facts clearly show that he spent extensive time in Hong Kong – that is 216 days in 2003/04, 241 days in 2004/05, and 257 days in 2005/06.

141. It was also clear that the Taxpayer and Mr F, his co-director of Company CC, both lived and worked in Hong Kong. In those circumstances, we therefore conclude that the controlling power and authority of Company CC was in Hong Kong and that Company CC was resident in Hong Kong. Indeed, as we have already stated above, Company CC's position with Company CB2 depended on its continued presence in Hong Kong. Of course, its business depended upon the maintenance of a legal practice in Hong

Kong.

142. For the reasons set out above, we conclude that, the Taxpayer has not discharged the burden placed on him of establishing that his employment with Company CC was not a Hong Kong employment. Applying the totality of facts test, it is quite clear that the Taxpayer's employment with Company CC was a Hong Kong employment.

Conclusion

143. After having carefully considered all the evidence before us and after having reviewed the written submissions of both parties, we conclude that the appeal must be dismissed. All that is left is for us to do is to thank all parties for their most helpful assistance in this matter.