

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D118/01

**Salaries tax** – income accrued was income of a firm – section 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Michael Neale Somerville and Robert Michael Wilkinson.

Date of hearing: 24 October 2001.

Date of decision: 14 December 2001.

The appellant objected to the salaries tax assessment for the year of assessment 1997/98 raised on him and claimed that the income accrued to him from Company A was the income of a firm of which he was the sole proprietor.

On 14 October 1994, the appellant applied for registration of a business carried on by him in Hong Kong. By a service agreement dated 1 March 1997 and signed by the appellant, the appellant accepted an appointment from Company A. Company A filed an employer's return of remuneration for the year ended 31 March 1998 in respect of the appellant. Upon the appellant's failure to submit his 1997/98 tax return, the assessor raised on him an estimated tax assessment. The appellant objected to the salaries tax assessment on the grounds that (i) the income reported in Company A's employer's return should represent the fee paid to his business for the services provided by him on behalf of his business and (ii) his business had been providing services to clients other than Company A. The appellant further contended that the service agreement with Company A was executed by him on behalf of his business.

#### **Held:**

1. The Board did not accept the appellant's testimony that his business, not the appellant, was the contracting party with Company A. If what Company A wanted was the services of the professional firm, Company A would and should have used the name of the professional firm, instead of the personal name of the appellant, as the contracting party; and Company A would and should have used the office address of the professional firm instead of the residential address of the appellant. The employer's return was another contemporaneous document indicating that Company A regarded the appellant, rather than the professional firm, as its employee. The terms and provisions of the service agreement provided further

## INLAND REVENUE BOARD OF REVIEW DECISIONS

support for the existence of an employer-employee relationship between Company A and the appellant.

2. The appellant has not discharged the onus under section 68(4) of proving that the assessment was excessive or incorrect.

### **Appeal dismissed.**

Chow Cheong Po for the Commissioner of Inland Revenue.  
Taxpayer in person.

### **Decision:**

1. This is an appeal against the determination of the Commissioner of Inland Revenue dated 22 June 2001 whereby the salaries tax assessment for the year of assessment 1997/98 under charge number 9-1651638-98-9, dated 12 November 1998, showing assessable income of \$2,136,610 was confirmed and tax payable thereon of \$320,491 was reduced to \$288,441 ('the Assessment').

### **The admitted facts**

2. Based on the facts stated in the determination and admitted by the Appellant, we make the following findings of fact.

3. The Appellant had objected to the salaries tax assessment for the year of assessment 1997/98 raised on him. The Appellant claimed that the income accrued to him from Company A was the income of a firm of which he was the sole proprietor.

4. On 14 October 1994, the Appellant applied for registration of a business carried on by him in Hong Kong under the business name of Company B ('the Business'). In his application, the Appellant stated that the Business was one of 'architectural, engineering, planning, interior design, project management, development consultation services and trading' and that the Business commenced operation on 19 September 1994.

5. By a service agreement dated 1 March 1997 ('the Service Agreement'), the Appellant accepted an appointment from Company A, among others, the following terms and conditions:

- ' 1. Term of employment

## INLAND REVENUE BOARD OF REVIEW DECISIONS

[Company A] shall engage and appoint and retain [the Appellant] who shall serve [Company A] in the position of Director of Property Development and subject to the provisions for determination of this Agreement hereinafter contained such engagement shall be for a period of two years commencing on the date hereof until the second anniversary of the date hereof and shall continue thereafter for successive terms of six months each commencing from the date next after the expiry of the then current term unless and until terminated in accordance with clause 7 hereunder.

### 2. Duties

- (a) For the duration of this Agreement, [the Appellant] shall observe the terms of the duties of the appointment as follows:
  - (i) as Director of Property Development, oversee the operation of property development projects undertaken and carried out by the Group in Hong Kong and PRC;
  - (ii) in the discharge of his duties and in the exercise of his powers observe and comply with the direction and instructions from time to time made or given by the Managing Director for the time being of [Company A]; and
  - (iii) devote substantially the whole of his energies and time to the business of the Group and use his best endeavors to develop and extend the business of the Group.
- (b) For the purposes hereof, [the Appellant] shall if and so long as he is so required by [Company A]:
  - (i) carry out the duties of his office (as the same is described in Sub-Clause (a)) on behalf of any subsidiary for the time being of [Company A];
  - (ii) carry out such duties attendant on any such appointment as if they were duties to be performed by him on behalf of [Company A] hereunder;
  - (iii) carry out such duties attendant on any such appointment always in the best interests of [Company A].

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (c) [The Appellant] shall at all times keep the Managing Director promptly and fully informed of his conduct of the business or affairs of [Company A] of the Group and provide such explanations as the Managing Director may be required in connection therewith.

### 3. Restrictions of other activities by [the Appellant]

- (a) For so long as [the Appellant] is engaged under the terms of this Agreement but without prejudice to Clauses 3(b), and 9 hereof, he shall not (except with the prior sanction of a resolution of the Board) be directly or indirectly engaged or interested in and other business which is in competition with or in opposition to the business carried on by any company in the Group ...

...

### 4. Remuneration and benefits

- (a) In consideration of [the Appellant's] service provided [Company A] shall pay him during the continuance of this Agreement a monthly salary of \$100,000 payable at the end of each calendar month.
- (b) In addition, [Company A] shall pay to him during the continuance of this Agreement for each completed year of service, a bonus of amount equivalent to one month basic salary.
- (c) [Company A] may, at its discretion and in accordance with the Executive Share Option Scheme, grant to [the Appellant] share options during the term of his appointment under this Agreement.

### 5. Expenses

[Company A] shall reimburse [the Appellant] in accordance with the company's policy all travel, hotel, entertainment and other out-of-pocket expenses reasonably incurred by [the Appellant] in or about the discharge of his duties hereunder.

### 6. Holidays

[The Appellant] shall be entitled to Twenty-one (21) calendar days' holiday (exclusive of statutory and bank holidays and sick leave) in each year to be taken at such times as may be convenient having regard to the requirements of the business of the Group. ...

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### 7. Termination

(a) This agreement may be terminated forthwith by [Company A] without prior notice if [the Appellant] shall at any time:

(i) commit any persistent or material breach of any of the provisions herein contained;

(ii) be guilty of any grave misconduct or willful neglect in the discharge of his duties hereunder:

...

(v) behave in such a manner or conduct with the express intention of bringing [Company A] into ill repute;

(vi) act against the interests of [Company A];

...

(b) (i) if [Company A] becomes entitled to terminate the appointment of [the Appellant] hereunder pursuant to Sub-Clause (a) it shall be entitled (but without prejudice to its right subsequently to terminate such appointment on the same or any other ground) to suspend [the Appellant] either on full or part payable or without payment of salary for so long as it may think fit.

(ii) Notwithstanding any other Clause in this Agreement, either [Company A] or [the Appellant] may terminated [*sic*] this Agreement by giving three (3) months of notice in writing.

...

### 8. Non-solicitation and restrictive covenants

(a) [The Appellant] agrees that for a period of one year after the termination of this Agreement:

(i) he will and will procure his associates (“his associates”) as defined in The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, not engage or be engaged in Hong Kong

## INLAND REVENUE BOARD OF REVIEW DECISIONS

and/or the People's Republic of China ("the Territory") whether directly or indirectly in the business of contracting in construction or construction-related work, provision for building related contracting services and the trading building materials ("Restricted Business");

- (ii) he will and will procure his associates not take employment with any person firm company or organization engaged in the Territory whether directly or indirectly in any business involving or related to any of the Restricted Business ...'

The Service Agreement was signed by the Appellant and Mr C for and on behalf of Company A.

6. The employer's return of remuneration and pensions for the year ended 31 March 1998 filed by Company A in respect of the Appellant disclosed, among others, the following particulars:

(a) Period of employment:	1-4-1997 to 31-3-1998
(b) Capacity in which employed:	Director of property development
(c) Income –	\$
Salary	1,193,548
Bonus	83,562
Gain realized under share option scheme	<u>859,500</u>
Total:	<u><u>2,136,610</u></u>

7. Upon the Appellant's failure to submit his 1997/98 tax return, the assessor raised on him the following estimated salaries tax assessment for the year of assessment 1997/98:

	\$
Assessable income	<u><u>2,136,610</u></u>
Tax payable thereon	<u><u>320,491</u></u>

8. The Appellant objected to the 1997/98 salaries tax assessment for the year of assessment 1997/98 on the ground that the assessment was incorrect.

- 9. (a) In his 1997/98 tax return submitted to validate his objection, the Appellant declared salary of \$200,000 derived from the Business as income chargeable to salaries tax.
- (b) The Appellant also declared that assessable profits of \$31,656 were accrued to him from the Business.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (c) The profit and loss account of the Business for the year ended 31 March 1998 submitted with the tax return showed the following particulars:

	\$
Service income received	<u>3,502,377</u>
Profit before taxation	37,242
<u>Less: Taxation</u>	<u>5,586</u>
Net profit	<u>31,656</u>

- (d) Note 4 to the profit and loss account of the Business stated:

‘Service Income received is the total amount of income received by [the Business] by providing Architectural, development consultation and Interior Design Services as [the Appellant] or [the Business] when entering into Service/employment Contract’.

10. The Appellant elaborated his ground of objection as follows:

- (a) The income reported in Company A’s employer’s return [paragraph 6] should represent the fee paid to the Business for the services provided by him on behalf of the Business.
- (b) The Business had been providing architectural, development consultation and interior design services to clients other than Company A.
- (c) The fee received from Company A amounting to \$2,136,610 had been included in the total fee income of \$3,502,377 as shown in the profit and loss account of the Business [paragraph 9(c)].

11. In response to the assessor’s enquiry, the Appellant contended the following:

- (a) ‘I have been practising as an architect providing full range of architectural services as well as development and project management consultancy work since 1993, I have set up the office with equipments and facilities, for example, drafting boards, parallel rules, computers ... I employ full time and part time contract staffs including architect, designers, draftspersons ... assisting to perform my duties and services to my clients. My office generally consists of a reception area, conference room, general office and drafting area ...’
- (b) ‘I got commissioned by clients to provide services ranging from architectural design, interior design, development and/or project management consultancy

## INLAND REVENUE BOARD OF REVIEW DECISIONS

work. I have an array of clients comprising of developers, contractors, builders, hoteliers, restaurant operators and homeowners ... Depends on the nature and size of the project sometimes a formal service contract will be executed or a letter of appointment or verbal agreement will be adequate.'

- (c) 'My architects or designers or drafting persons under my direction usually work full time or part time in my office. I, myself usually work in my office except making site visits. Sometimes at the request of a particular client I may work some time in their office. So I can liaise and co-ordinate with the staffs of my client in order to perform my duty and service, usually that is more on the development and project management side. I would also represent my client to deal with other parties.'
- (d) 'The mode of payment for my service: ... The payment could be a regular monthly payment, for example, [Company A], usually it is for development consultancy or project management consultancy work. ...'
- (e) '[the Service Agreement] was a standard contract for Company A senior executives, it was merely meant to be a work copy since my service is kind of unique to their current operation. All of their staffs are employees.) then we have been revising the Service Contract back and forth and we were too busy to complete the proper Service Contract, ...'
- (f) His title with Company A was director of real estate development. His duties and responsibilities were to assess the possibilities of development projects which came through Company A. His effort was exerted on a mixed-use development in Province D in China, a 83,000 square metre residential and commercial building complex. He travelled frequently to check the performance of the local staff. He directed and advised them on the overall planning and development of the project. He reported to the chairman of the board and advised him on the progress.
- (g) 'The remuneration of my services is a regular monthly payment of \$100,000 plus stock option plus one month bonus at the end of one year of continue consultancy service.'
- (h) 'I do not have to attend office at regular hours but I do attempt to go to the office once everyday except when I am on trip or the chairman is on trip. I report to Company A's headquarters where they allocate a room for me and later on when there is not enough space for their growing staffs, I am requested to work in my own office and whenever the chairman needs me he will summon my presence other than regular status report. I do not have to follow any work schedule or

## INLAND REVENUE BOARD OF REVIEW DECISIONS

time-schedule or time-table set by [Company A]. Obviously I have to give Company A priority and fit my schedule around it as much as possible because of the nature of the projects that I have been working on. Sometimes I need the back up of my staffs to provide services to Company A.'

- (i) He had to set up an office, to provide equipment and facilities and to employ his own assistants to perform his duties.
- (j) 'I am permitted to work for other organization and no prior approval is required to be sought from my employer. It is evident that I keep my office in full operation all the time during my term of service with Company A and at times Company A requires extra architectural work from [the Business] and they pay directly to [the Business] in additional to my regular monthly consultation fee to [the Business].'
- (k) 'I did not receive sick leave, medical benefit and provident fund because basically I had my own practice and I worked on flexible hours but I did have stock option as an inducement for my consultancy service.'
- (l) 'I only check with the chairman on leave because I promise to give priority to Company A and would try my best to work around his schedule and I do not need to seek approval from other officers of Company A.'
- (m) 'I am responsible to the chairman of [Company A]. [The Business] is independent from Company A and [Company A] has no control over my activities.'
- (n) 'The employment/Services Contract can be terminated by either party by giving other party three month notice. In my case, it was mutual release owing to the change of the financial status of [Company A], the market downfall of real estate development which plagued [*sic*] the economy of Hong Kong and China.'

12. The Appellant provided the following documents:

- (a) Business cards of himself and a 'contract staff' also to show the then address of the Business.
- (b) Copies of three business cards of himself to show the previous addresses of the Business.
- (c) Project list of the Business to show the names of clients and related projects.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (d) Copies of correspondence, minutes, quotation, statement of account and telephone bills to show the kinds of services provided by the Business.
- (e) Copy of the Service Agreement with amendments to the effect that the Appellant signed the Service Agreement for and on behalf of the Business.
- (f) Copies of invoice statements dated 20 August 1997 issued by the Business to Company E of the Mainland and Company A charging fees for professional services rendered to show that the Business 'further charged Company A additional fee when [the Appellant] provided them architectural services'.
- (g) Copy of the Appellant's letter dated 1 February 1999 issued to Company A regarding the termination of the Service Agreement. The Appellant also confirmed that with effect from 31 January 1999, the Service Agreement had been terminated by mutual consent and that he would have no further lien against Company A upon satisfactory arrangement of settlement of outstanding salary, fee and reimbursement on miscellaneous expenses.

13. In the light of the information obtained, the assessor was of the view that the income the Appellant derived from Company A should be chargeable to salaries tax instead of profits tax. The assessor requested the Appellant to consider withdrawing his objection.

14. The Appellant refused to withdraw his objection and contended the following:

'My Service Agreement was executed by me on behalf of [the Business] and with [Mr C], Chairman of [Company A] on behalf of [Company A]. He and I negotiated the content, terms and conditions of the Agreement ... [the Appellant] was not the party of the Agreement, in fact he entered into the Agreement on behalf of [the Business].'

15. In support of his contention, the Appellant provided a letter dated 7 September 1999 from Company A signed by Mr C in the capacity of chairman and managing director stating that the Service Agreement should be interpreted as meaning that the party that provided the service should be the Business and not the Appellant personally.

16. The assessor ascertained that the notes to the published financial statements of Company A for the year ended 30 June 1998 contained the following statements:

'On 1 July 1993, [Company A] approved a share option scheme under which the directors may, at their discretion, at any time during the ten years from the date of approval, invite any eligible employee of the Group to take up options to subscribe for shares of [Company A]. Such options will lapse on the voluntary resignation or termination of any eligible employee's employment in accordance with the termination

## INLAND REVENUE BOARD OF REVIEW DECISIONS

provisions of his contract of employment other than by reason of redundancy ... The aforesaid share option scheme became effective upon the listing of [Company A's] shares and warrants on The Stock Exchange of Hong Kong Limited ... on 21 July 1993.'

### **The appeal**

17. The Commissioner confirmed the amount of assessable income but reduced the amount of tax payable by 10% to \$288,441 to give effect to the Tax Exemption (1997 Tax Year) Order.

18. By letter dated 12 July 2001, the Appellant gave notice of appeal.

19. The Appellant's evidence on the signing of the Service Agreement may be summarised as follows:

- (a) He had known Mr C for a few years.
- (b) His first dealing with Company A was a feasibility report which he prepared after going to Province D at Mr C's request. Fees were paid by Company A.
- (c) Around Chinese New Year in 1997, he met Mr C at the latter's request. Mr C told him that 'hey, [the Appellant], may be we need more your services, your firm'; that 'I need your service, your firm's service urgently'; that he needed a good professional firm to provide them with solid support; and that he brought out 'that service agreement'.
- (d) After Mr C had told him about fees, share option and other matters, the Appellant said that that was not really a proper service contract but Mr C said 'Well, that will serve as a basis. I need to talk to the board to say whether your firm accepts our appointment or not, then we will embark on that project'. 'So kind of in that haste', the Appellant said 'well, okay, fine, the business term is alright. I need the fee to be paid on the regular basis so I can look after my staff for payment and what not'.
- (e) He believed he signed the Service Agreement on that occasion though he was not sure and added that it might have been shortly after that.

### **Our decision**

20. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Appellant.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

21. We do not accept the Appellant's testimony that the Business, and not the Appellant, was the contracting party with Company A. We reject his contention that the income that accrued to him from Company A was the income of the Business.

22. At the time the draft Service Agreement was prepared by Mr C and Company A, Mr C knew the name of the professional firm and the business address of the professional firm, having been billed by the professional firm before. If what Company A wanted was the services of the professional firm, Company A would and should have used the name of the professional firm, instead of the personal name of the Appellant, as the contracting party; and Company A would and should have used the office address of the professional firm instead of the residential address of the Appellant.

23. If the Appellant had intended the professional firm to be the contracting party, he could easily have crossed out the name of the professional firm and written his personal name on the Service Agreement **before** he and Mr C signed it.

24. The employer's return for the year ended 31 March 1998 is another contemporaneous document indicating that Company A regarded the Appellant, rather than the professional firm, as its employee.

25. The letter dated 7 September 1999 from Mr C was not a contemporaneous document and we attach no weight to it.

26. In his letter to Company A dated 1 February 1999 referring to the 'Termination of Service Agreement dated 1 March 1997', the Appellant referred to 'satisfactory arrangement of settlement of outstanding **salary**, fee and reimbursement on miscellaneous expenses' (emphasis added) and signed in his own name, not in the name of professional firm, and not for and on behalf of the professional firm. This is another contemporaneous document pointing to an employer-employee relationship. We do not accept the Appellant's explanation for signing in his own name. This letter had nothing to do with his architectural firm. As he said in his letter dated 26 May 1999, 'my Company B further charged Company A additional fee when I provided them architectural services'.

27. The terms and provisions of the Service Agreement provided further support for the existence of an employer-employee relationship between Company A and the Appellant.

- (a) The Appellant was called 'the Officer' under the Service Agreement. This was not appropriate for a professional firm.
- (b) The position of the Appellant was 'Director of Property Development' which was not appropriate for a professional firm.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (c) The duties included overseeing the operation of property development projects undertaken and carried out by the group, in contrast with day to day architectural work or day to day work of a consultant or authorised person.
- (d) The 'salary' and the extra month 'basic salary' bonus were common employment terms.
- (e) The share option scheme was restricted to employees of the listed group. We see no reason why Company A should have granted a share option to the Appellant and allowed him to exercise his option if the Appellant were not a bona fide employee of the listed group.
- (f) It was inherently improbable for Company A to have deviated from its share option scheme for employees by granting a share option to a professional firm.
- (g) The granting of 21 calendar days' holidays, exclusive of statutory and bank holidays and sick leave, in each year would hardly have been appropriate for a professional firm.
- (h) Company A's entitlement under clause 7(a)(v) to terminate the Service Agreement on the ground of behaviour or conduct with the express intention of bringing the company into ill repute was more appropriate for the dismissal of an employee than for terminating the contractual relationship with a professional firm.

### **Disposition**

28. The Appellant has not discharged the onus under section 68(4) of proving that the Assessment is excessive or incorrect. We dismiss the appeal and confirm the Assessment.