

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D11/82

*Board of Review:*

S. V. Gittins, *Chairman*; W. T. Grimsdale, Professor P. G. Willoughby & David C. S. Wu, *Members*.

### 30 July 1982.

Salaries Tax—whether section 8(1) or section 8(1A) of the Inland Revenue Ordinance applies—employee of Overseas Corporation assigned to Hong Kong—salary paid part in Hong Kong and part in U.S.—duties performed outside Hong Kong for subsidiaries of employer—whether two separate contracts of employment—whether right of apportionment of salary in respect of services performed in and outside Hong Kong.

The appellant was employed by a foreign corporation as manager and managing director of a Hong Kong subsidiary. The appellant had certain duties outside Hong Kong and for non Hong Kong companies was also designated managing director of a subsidiary outside Hong Kong. Part of his salary was payable in Hong Kong and part including an accommodation allowance was payable into an account overseas. The appellant was assessed to Salaries Tax for years 1976/77, 1977/78 and 1978/79 on both parts of his salary. The appellant appealed on the grounds that part of his income related to his services rendered outside Hong Kong to his overseas employer and its overseas subsidiaries and that an exclusion of part of his income on a time apportionment basis should be made when assessing the charge to Hong Kong Salaries Tax.

#### **Held:**

- (1) The appellant's income was derived from a single contract of employment and could not be apportioned in respect of service provided inside and outside Hong Kong.
- (2) Where income from employment stems mainly from Hong Kong based activities all the remuneration will be assessable to Salaries Tax without any right to apportionment.

Appeal dismissed.

Wong Ho-sang for the Commissioner of Inland Revenue.  
D. Flux of Peat, Marwick, Mitchell & Co. for the appellant.

*Reasons:*

1. The following facts are agreed or found by the Board:—
  - (a) In 1977, The Taxpayer was offered an assignment by an American Company, New Jersey, U.S.A. which he accepted while he was in England on 5th March 1977. The assignment is contained in a document which began as follows:—

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“The following provisions will apply during your assignment in Hong Kong as Manager, Southeast Asia and Managing Director of (CFE)”.

- (b) The document states that the location of the assignment is Hong Kong and it provides for the transportation of the Taxpayer, his family and his household and personal effects to Hong Kong, home leave transportation to England, and transportation back to England on the termination of employment.
- (c) The document shows that the Taxpayer’s base salary was US\$3,000 per month which was split as to US\$2,795 payable in Hong Kong and US\$205 paid to the Taxpayer’s account with “CFE Wayne”. In addition a Foreign Service Allowance based in part on cost of living indices for Hong Kong and subject to revision, but was US\$336 per month in 1977 and was “added to your Wayne salary”. In addition, an allowance for accommodation in Hong Kong was also added to the Wayne payment.
- (d) CFE is a company incorporated in Hong Kong and is a wholly owned subsidiary of ACC. CFE’s principal activities are to handle marketing in the Eastern Hemisphere of pharmaceutical and chemical products manufactured by ACC and affiliated companies.
- (e) The Taxpayer, accompanied by his family, arrived in Hong Kong on 6th March 1977 to assume the above post. Employer’s Return for 1976/77 and 1977/78 in respect of the Taxpayer were filed by CFE with the Inland Revenue Department. The Taxpayer submitted his Salaries Tax Returns for 1976/77 and 1977/78 showing the following particulars:—

Employer’s Name: CFE

Capacity in which employed: Managing Director

Income:

Year of Assessment:	1976/77	1977/78
Period:	1.1.77 to 31.3.77	1.4.77 to 31.3.78
Amount:	\$37,000	\$101,000
Quarters provided by Employer:	No accommodation provided	Hotel room from 1.4.77 to 10.6.77 and a flat from 11.6.77 to 31.3.78.
Rent paid to Employer:	—	\$23,436

The following note was appended to the Taxpayer’s 1977/78 Salaries Tax Return:—

“(the Taxpayer) received during the year ended 31st March 1978 the sum of US\$23,295 (ACC) for the services he rendered outside Hong Kong on behalf of that Company and certain other non Hong Kong Group Companies. The duties relating to this remuneration were performed outside Hong Kong and were neither for the benefit of nor relating to the activities of CFE.”

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(f) The Taxpayer pointed out that the portion of his salary received in U.S.A. was for duties performed outside Hong Kong, adding that he was also Managing Director of C. Thailand Ltd. as well as having responsibility for several countries in Asia. On this basis, he claimed exemption from Salaries Tax on the portion of remuneration paid outside Hong Kong.

(g) Subsequently the Taxpayer's Representative informed the Assessor that the remuneration paid in the U.S.A. for the year ended 31st March 1978 should be reduced from US\$23,295 to US\$17,038. In respect of the overseas income the Representatives stated as follows:—

- “ (a) The cost of (the Taxpayer's) overseas salary is borne by (ACC).
- (b) The basis of the compensation split is according to the quantum of (the Taxpayer's) services rendered for Hong Kong and other overseas regions. (ACC) has the sole discretion to change the system.
- (c) (The Taxpayer's) travelling and other overhead expenses were partly charged to (CFE), partly to (ACC), C. Bangladesh and C. Bangkok. Only the amounts he drew from (CFE) were reflected in the accounts of the local company. However, such expenses should have not bearing on (the Taxpayer's) Salaries Tax position.
- (d) (The Taxpayer) only arrived in Hong Kong on 7th March 1977. His itinerary for the period 1st April 1977 to 31st March 1978 is enclosed herewith for your reference. As our client has explained in detail, he has regional responsibilities in any regions other than Hong Kong and when he is outside the Colony, he performs duties either for the region which he is visiting or on behalf of (ACC). It appears therefore inappropriate and needlessly onerous and time consuming to attempt to identify closer details of the business transacted during each visit which may just consist of signing a couple of documents, authorising the use of the company's stamps, or complicated negotiations on building new factories, etc. we trust therefore that the information supplied will be sufficient.”

(h) The Assessor raised 1976/77 and 1977/78 Salaries Tax Assessments on the Taxpayer on 20th February 1979 and 21st February 1979 respectively as follows:—

1976/77	
Hong Kong Salaries & Bonus .....	\$37,000
US Salary—3 months @ US\$205 converted @ 4.6248 .....	2,844
Incidental allowance—US\$1,500 converted @ 4.6248 .....	6,937
Sustenance allowance (estimated) .....	<u>15,000</u>
	\$61,771
Add: Quarters Rental Value at 10% .....	<u>6,177</u>
	\$67,948
Less: Personal Allowances .....	<u>31,000</u>

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Net Chargeable Income.....	\$36,948	=====
1977/78		
Hong Kong Salary .....	\$101,000	
US Salary—US\$20,912 @ 4.6356 .....	96,939	
School fees .....	3,034	
Substenance (estimated) .....	<u>12,500</u>	
	\$213,473	
Add: Quarters Rental Value at 10% .....	\$21,347	
Deduct: Rental paid to Employer .....		
US\$3,877.50 @ 4.6356 .....	17,974	<u>3,373</u>
Net Chargeable Income.....	\$216,846	=====

- (i) On 4th July 1979, the Taxpayer filed 1978/79 Salaries Tax Return. The Assessor raised the following 1978/79 Salaries Tax Assessment on the Taxpayer on 21st December 1979:—

Hong Kong Salary .....	\$ 96,000	
US Salary—US\$28,979 @ 4.7166 .....	<u>136,682</u>	
	\$232,682	
Add: Rental value of quarters—		
10% of total income .....	\$23,268	
Less: rental contribution US\$5,436 @ 4.7291 .....	25,707	<u>NIL</u>
Net Chargeable Income .....	\$232,682	=====

2. The Representatives lodged objections to the assessments in sub-paragraphs (h) and (i) of paragraph 1 above.

3. The Commissioner's Determination on the objections are as follows:—

- (1) Salaries Tax Assessment for the year of assessment 1976/77 under Charge No. 087-4106087B, dated 20th February 1979, showing Net Chargeable Income of \$36,948 with Tax Payable thereon of \$4,389 is hereby reduced to Net Chargeable Income of \$20,886 with Tax Payable thereon of \$1,632.
- (2) Salaries Tax Assessment for the year of assessment 1977/78 under Charge No. 088-0673877, dated 21st February 1979, showing Assessment Income of \$216,846 with Tax Payable thereon of \$32,526 is hereby reduced to Assessable Income of \$212,772 with Tax Payable thereon of \$31,915.

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- (3) Salaries Tax Assessment for the year of assessment 1978/79 under Charge No. 089-3493376, dated 21st February 1979, showing Assessable Income of \$232,682 with Tax Payable thereon of \$34,902 is hereby increased to Assessable Income of \$235,418 with Tax Payable thereon of \$35,312.
4. From this Determination the Taxpayer has appealed to the Board of Review through his Representatives.

“The grounds for the appeal are that part of our client’s income related to his services rendered outside Hong Kong on behalf of his overseas employer and other subsidiaries in the South East Asian countries. It is contended that such income did not arise in or derive from Hong Kong and therefore should be excluded for Hong Kong tax purposes. An exclusion on a time-apportionment basis by reference to the number of days outside Hong Kong should be taken into account for the calculation of the income chargeable to Hong Kong Salaries Tax. Accordingly, the determination of the Commissioner is erroneous and should be set aside.”
5. The Taxpayer gave evidence on oath before the Board as follows:—

  - (a) The assignment document of 5th March 1977 was an assignment by ACC to the posts of Managing Director of CFE and Manager, South East Asia of ACC interests in that region which were outside of CFE responsibilities.
  - (b) In CFE there was no post of Manager, South East Asia.
  - (c) There were about 16 ACC companies in South East Asia. The Taxpayer’s function was to be stationed in Hong Kong and to act on instructions from ACC in respect of those companies.
  - (d) The Taxpayer was concerned in the South East Asia region with ACC products which were not dealt with by CFE.
6. In answer to questions put in cross examination and by the Board—

  - (a) On a document headed “1980 CFE AREA CHART” which showed the Taxpayer as Managing Director and under him *inter alia* the Manager Singapore office and C. Thailand Ltd., the Taxpayer stated that he was the Managing Director of C. Thailand Ltd., a wholly owned subsidiary of ACC.
  - (b) On a letter from ACC to the Commissioner of Inland Revenue dated 15th November 1978 concerning 2 other employees of CFE which stated that there was no straight-forward answer to the question as to which countries in the Far East Region was responsible to CFE because some business from those countries was done through CFE and other business between ACC subsidiaries; that Bangladesh, Nepal and Sri Lanka had no direct business with CFE; that Burma, Thailand and Indonesia had limited direct business with CFE; that the majority of business of Singapore, Hong Kong and Korea was direct with CFE; while direct business between the Peoples Republic of China and CFE was both limited and major. The

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Taxpayer gave no clear answer to questions on this point. It was put to the Taxpayer that the administration responsibility as distinct from sales responsibility of those territories outside of Hong Kong fell within his function as Managing Director CFE. He maintained this administration responsibility fell within his post as Manager, South East Asia of ACC.

- (c) With respect to newspaper items which reported that the medical department of CFE controlled the whole of South East Asia, the Taxpayer stated that the items were inaccurate and only referred to pharmaceutical products, whereas ACC sold other products in the region which were not within the responsibility of CFE, including industrial and agricultural chemicals and formica.
- (d) With respect to the split in the payment of his salary between Hong Kong and Wayne, the Taxpayer stated that the division was arbitrary, that he estimated the Hong Kong portion to represent the proportion of his time spent in Hong Kong and that this was approved by ACC. The Taxpayer said that an element in the split was his personal need to meet Hong Kong expenditure.
- (e) No tax return was made in respect of the Taxpayer's salary in any of the ACC subsidiaries in territories in South East Asia, including C. Thailand Ltd. of which he was Managing Director.

7. The case for the Revenue is that:—

- (a) The assignment of the Taxpayer by ACC was one single assignment, and that was to Hong Kong. He received one salary although split at his own request, a Hong Kong housing allowance and a Foreign Service Allowance for Hong Kong, so that the whole package of his emoluments should be viewed as relating to his post here;
- (b) A letter from the Taxpayer's Representatives to the Revenue dated 13th November 1980 states in part that the principal activities of CFE are to sell and distribute pharmaceutical and chemical products manufactured by its parent company and affiliated companies.
- (c) The CFE area chart shows that the Singapore and Thailand are parts of the CFE organisation.
- (d) A letter dated 18th November 1974 from the Representatives to the Revenue states that CFE acts as the Far East Sales Office, the ACC subsidiary responsible for the international marketing of C. products.
- (e) CFE was originally incorporated under the name of Hong Kong Ltd. The name was changed to CFE and could be indicative of an expansion of its sphere of operation.

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8. It appears to the Board that a crucial point to be decided is whether the Taxpayer held 2 separate positions as Managing Director CFE and Manager, South East Asia of ACC. We find that the fact that he claims to be directly responsible to ACC on the latter is a neutral point in that he is likewise directly responsible to ACC as Managing Director CFE. The fact that the Taxpayer is Managing Director of the Thailand company is a point in his favour, but this is discounted on his testimony that this is title used as a matter of convenience when engaged in negotiations in that country. That no tax return was made in Thailand or any of the other South East Asia countries suggests that no part of the Taxpayer's salary was attributable to those territories. The Taxpayer also testified that he carried different visiting cards and he used the one appropriate to the territory he was in and to the party he was dealing with.

9. We find that a material point against the Taxpayer's case is the absence of any separate job specifications for the 2 positions. The document of assignment is vague, suggesting that ACC in making the assignment did not have definite ideas as to different functions for the appointments as Managing Director, CFE and Manager, South East Asia. Even a telex from Wayne dated 13th July 1982 produced at the hearing fails to establish that the Taxpayer had 2 separate jobs. The relevant part of the telex states—“(the Taxpayer) as Managing Director CFE and Manager, South East Asia can be requested to attend duties not only outside Hong Kong but anywhere within C. at discretion of superiors.”

Further, although his emoluments are split with part payable in the U.S.A., we are not satisfied that the U.S.A. portion is attributable to employment by ACC as manager, South East Asia. It is also somewhat anomalous that his Foreign Service Allowance for residence in Hong Kong and his allowance for accommodation in Hong Kong should be included in the U.S.A. portion.

10. The Determination of the Commissioner is premised on the finding that the Taxpayer held one post located in Hong Kong. We agree with the Commissioner and hold that the Taxpayer's contract of service with ACC was one under which he was assigned to run the Corporation's South East Asian activities from a base in Hong Kong.

11. As to the Taxpayer's liability to Salaries Tax, section 8(1)(a) of the Inland Revenue Ordinance tax is charged in respect of income arising in or derived from the Colony from any office or employment of profit. Section 8(1A)(ii) excludes from section 8(1)(a) income, income derived from services rendered by a person who renders outside the Colony all the services in connexion with his employment.

12. While it is an agreed fact that the contract of employment was entered into out of the Colony, either in the U.S.A. or in both U.S.A. and U.K., we do not think that this affects the fundamental or originating cause of the Taxpayer's means of earning income which was, in our view, his assignment to work for ACC from a base in Hong Kong. Reference was made to section 14, the charging section for Profits Tax, in which the same words “arising in or derived from” are used and to the case law on the section. It was suggested that *CIR. v. The Hong Kong and Whampoa Dock Co. Ltd.* (1960) HKTC 85 and *CIR v. International Wood*

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*Products Ltd.* (1971) HKTC 551 were authorities which supported the view that the place where services are rendered or work is done are the critical factors in deciding source for Profits Tax and that a similar approach should be adopted for Salaries Tax. In theory we would agree but there is, in our view, a fundamental distinction between a business which earns profits from a series of separate contracts and an employment which earns income from a single indivisible contract of employment. In reaching its conclusions in the above two Profits Tax cases the Supreme Court was faced with contracts which had both Hong Kong and offshore elements but was forced to decide on which side of the boundary the profits arose and in doing so looked to the locality where they arose as being determined by the considerations which fastened upon the acts more immediately responsible for the receipt of profits (of *C.T. (NSW) v. Hillsdon Watts Ltd.* (1936) 57 CLR 36 at 51). We think that the same approach is appropriate in the case of Salaries Tax with the difference that one is generally dealing with one indivisible contract with the result that where the Hong Kong factors override the offshore factors the entire remuneration is liable to Salaries Tax. This has in the past often been referred to as the “situs of employment” test, a term which we regard as possibly misleading as it tends to obscure the basic test in section 8(1) which is source in *income*.

13. The question of apportionment was raised by Mr. Flux on behalf of the Taxpayer. In this connection it was not disputed that the Taxpayer spent 128 days out of the Colony on business in 1977/78 and 104 days on business out of the Colony on business in 1978/79. However, since our finding is that the Taxpayer’s income is derived from a single contract assigning him to duties to be undertaken substantially from a base in Hong Kong we can find no legal basis for dividing up his services and apportioning his remuneration. We regard his income as a single indivisible sum that was derived from a single contract and accordingly we consider that apportionment is not permitted. Mr. Flux pointed out that apportionment on a “time in time out” basis was common under section 8(1A)(a). This we accept. However, this paragraph seems to us to apply in the situation where the circumstances giving rise to the employment income are essentially offshore with the result that in the absence of that paragraph Salaries Tax would not be payable in respect of any services rendered in Hong Kong. In summary therefore it seems to us that the matter might be put in these terms. Where income from an employment stems mainly from Hong Kong based activities all the remuneration will be assessable to Salaries Tax without any right to apportionment. Where, however, income from employment stems mainly from offshore based activities all the income would escape Salaries Tax were it not for section 8(1A)(a) which by implication authorises an apportionment on a “time in time out” or other appropriate basis in order to separate out the taxable proportion of total remuneration received for rendering services in Hong Kong.

14. We hold that in this case all the Taxpayer’s income is derived from the Colony from an employment of profit and therefore falls within section 8(1)(a) without any apportionment for services rendered outside Hong Kong.

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15. The appeal is dismissed and the assessments for the years of assessment 1976/77, 1977/78 and 1978/79, as amended by the Commissioner in his Determination, are confirmed.