Case No. D125/02

Salaries tax – whether income derived from Hong Kong from a source of employment – sections 8, 8(1), 8(1A) and 52(3) of the Inland Revenue Ordinance ('IRO') – Departmental Interpretation and Practice Note No 10 (Revised) ('the Practice Note').

Panel: Ronny Wong Fook Hum SC (chairman), Andy Lam Siu Wing and Wong Kwai Huen.

Dates of hearing: 30 November 2002 and 28 January 2003.
Date of decision: 6 March 2003.

Company A-Singapore is a company incorporated in Singapore. At all material times, Mr B was the regional director attached to Company A-Singapore. Company A-Hong Kong is a company incorporated in Hong Kong.

During the recruitment exercise of a 'Managing Director for the Greater China Region' who 'could be based either in Hong Kong or Beijing' and 'is expected to work closely with the existing team of 19 in Hong Kong, and a compact team of mainland Chinese staff in Beijing once the rep office becomes operational', the appellant flew from Hong Kong to Singapore for an interview with Mr B. The interview went well and the appellant was invited to go to London immediately for a further interview in Company A's head office. By letter dated 20 June 1996 ('the Offer Letter'), Company A-Singapore offered the appellant the position of 'Managing Director – Greater China'. The Offer Letter was sent to the appellant in Hong Kong where the appellant despatched his acceptance of the offer. On 24 July 1996, the appellant was appointed director of Company A-Hong Kong.

Since 9 May 1995, Company A-Hong Kong adopted a national mutual central provident fund ('the Fund') as a retirement fund for such of its employees who became members of the Fund. On 15 January 1997, the appellant wrote to Mr G, regional finance manager with Company A-Singapore, and invited Mr G to consider incorporating 'in the HK plan' his provident fund entitlement provided for in the Offer Letter. By letter dated 17 January 1997, Company A-Hong Kong declared the enrolment of the appellant under the Fund.

Mr B wrote to the appellant on 17 March 1997 and referred to 'the success of the Taiwan deal' and the appellant's 'leadership in Hong Kong and China'. Mr B informed the appellant that his base salary was raised.

According to an employer's return dated 30 April 1997 ('the 97 Return') signed by the appellant as the general manager of Company A-Hong Kong, the appellant was employed as general manager of that company since 24 July 1996. No part of his salary was stated as having been paid by Company A-Singapore as 'an overseas concern' in the space reserved for the purpose. With effect from 2 November 1996, Company A-Hong Kong provided him with quarters. Company A-Hong Kong omitted to state in this return that a car allowance was also paid to the appellant. The employer's returns of Company A-Hong Kong dated 25 May 1998 ('the 98 Return') and 20 April 1999 ('the 99 Return'), both signed by the appellant as general manger, informed the Revenue that the appellant earned a salary and commission and no part of the salary was stated as having been paid by Company A-Singapore as 'an overseas concern' in the space provided. Company A-Hong Kong still provided quarters to the appellant. The wages depicted in the 97, the 98 and the 99 Returns were paid by Company A-Hong Kong into a bank account of the appellant in Hong Kong.

In his tax returns - individuals for the years of assessment 1996/97 to 1998/99, the appellant claimed that Company A-Singapore was his employer and only part of his income from Company A-Singapore attributable to services rendered in Hong Kong should be assessed to salaries tax. The appellant sought to apportion his income by reference to the number of days which he spent in Hong Kong. Reliance was placed on the Revenue's Practice Note.

Held:

1. The question posed by section 8(1) of the IRO is this: is the income derived from Hong Kong from a source of employment or is it not? The key element to be identified is the source of income as opposed to the location of employment. The place where the services are rendered is not relevant to the inquiry under section 8(1) as to whether income arises in or is derived from Hong Kong from any employment. It should be completely ignored. The Board must look at all relevant facts but disregard the place where the services were rendered in determining the source of income. There is no justification for the three tests as promulgated by the Commissioner in the Practice Note. It is contrary to the 'totality of facts test' set out by Macdougall J in CIR v Goepfert to say that if a taxpayer complies with the three tests he is not taxable in Hong Kong.

2. The appellant drew the Board's attention to section 52(3) of the IRO whereby a director is deemed a person employed by a company for the purpose of submission of return in respect of remuneration paid to such employee. The Board did not find such explanation adequate or sufficient. Section 52(3) merely includes director of a company as employee for the purpose of submission of a return. That subsection does not impose any obligation to report any remuneration when in truth no such

remuneration had been paid to the director in question. Furthermore, the returns were in respect of earnings paid to the appellant as general manager.

3. In order to tackle the concerns that the Board had expressed, the appellant tendered two statements. No attempt was made by the deponents to tender any primary evidence in support of their assertions. Had the appellant been part of the work force of Company A-Singapore, one would expect that fact to be reflected in the books of account of Company A-Singapore and in correspondence between Company A-Singapore or the appellant with the Singapore fiscal authority. The appellant did not tender these two deponents for cross-examination. In these circumstances, the Board was not prepared to attach any weight to their statements.

4. The Board was of the view that the issue was one of contractual intention and the relevant test to be applied was an objective test. The Board has reminded itself that its task was to identify the source of the appellant's income and to look for the place where the income really came to the appellant. The Board has to determine this question as a matter of reality. The Board took the view and it so found that it was agreed between Company A-Singapore, Company A-Hong Kong and the appellant that as from 24 July 1996, the appellant should be employed by Company A-Hong Kong as its general manager and be remunerated as such in Hong Kong. On this basis, the Board was of the view that the appellant's income arose in or was derived from his employment as general manager of Company A-Hong Kong and he was correctly assessed as such.

Appeal dismissed.

Cases referred to:

CIR v Goepfert 2 HKTC 210
D79/97, IRBRD, vol 12, 461
D40/90, IRBRD, vol 5, 306

Wong Kai Cheong for the Commissioner of Inland Revenue.
Lee Hung Chak of Wintech Corporate Services Limited for the taxpayer.

Decision:

Facts as found by this Board

1. Company A-Singapore is a company incorporated in Singapore. At all material times, Mr B was the regional director attached to Company A-Singapore.

2. Company A-Hong Kong is a company incorporated in Hong Kong on 24 February 1990. Prior to 30 April 1996, its board of directors consisted of Mr B, Mr C and Mr D. Mr D resigned as a director of Company A-Hong Kong on 30 April 1996. At all material times, it maintained an office in Wanchai. Its principal activities consisted of sale of banknote counting, sorting and dispensing machines and the provision of maintenance services for such machines.

3. By letter dated 13 March 1996, Company E offered its service to Mr B in the 'recruitment of a Managing Director for the Greater China Region'. It was envisaged that the managing director 'could be based either in Hong Kong or Beijing' and he 'is expected to work closely with the existing team of 19 in Hong Kong, and a compact team of mainland Chinese staff in Beijing once the rep office becomes operational'.

4. Company E approached the Appellant in Hong Kong around mid May 1996. On 9 June 1996, the Appellant flew to Singapore for an interview with Mr B. The interview went well. The Appellant was invited to go to London immediately for a further interview in Company A's head office. The London interview was also a success. The Appellant returned to Singapore with Mr B.

5. By letter dated 20 June 1996 ('the Offer Letter'), Company A-Singapore offered the Appellant the position of 'Managing Director – Greater China' commencing on 29 July 1996 upon the following terms and conditions:

(a) 'BASIC SALARY: Your commencing basic salary will be HK$1,300,000 per annum paid over 12 months. Your next salary review will be on the 1st of April 1997'.

(b) 'PROVIDENT FUND: Both the employee and the company will contribute to the Employees Provident fund. The Employer contributes 7.5%, and the Employee contributes 7.5%'.

(c) 'NOTICE OF TERMINATION: The period of notice to terminate this contract of service by either party after confirmation of service will be three (3) months'.

6. The Offer Letter was sent to the Appellant in Hong Kong. The Appellant despatched his acceptance of the offer after he returned to Hong Kong.

7. On 24 July 1996, the Appellant was appointed director of Company A-Hong Kong. According to an employer's return dated 30 April 1997 ('the 97 Return') signed by the Appellant

as the general manager of Company A-Hong Kong, the Appellant was employed as general manager of that company from 24 July 1996. His salary for the period between 24 July 1996 and 31 March 1997 was $793,717. No part of that salary was stated as having been paid by Company A-Singapore as 'an overseas concern' in the space reserved for the purpose. With effect from 2 November 1996, Company A-Hong Kong provided him with quarters in Villa F ('the First Villa F Flat'). Company A-Hong Kong omitted to state in this return that a car allowance in the sum of $49,573 was also paid to the Appellant.

8. Since 9 May 1995, Company A-Hong Kong adopted a national mutual central provident fund ('the Fund') as a retirement fund for such of its employees who become members of the Fund. On 15 January 1997, the Appellant wrote to Mr G, regional finance manager with Company A-Singapore, in relation to his provident fund entitlements as provided for in the Offer Letter. The Appellant invited Mr G to consider incorporating his plan 'in the HK plan'. After discussing the issue with Mr B, Mr G gave instructions to Company A-Hong Kong. Pursuant to such instructions, Company A-Hong Kong declared by letter dated 17 January 1997 the enrollment of the Appellant under the Fund.

9. Mr B wrote to the Appellant on 17 March 1997. He referred to 'the success of the Taiwan deal' and the Appellant's 'leadership in Hong Kong and China'. He informed the Appellant that his base salary was amended to $1,410,000 per annum.

10. By an employer's return dated 25 May 1998 ('the 98 Return'), Company A-Hong Kong reported to the Revenue the salary and commission earned by the Appellant as 'General Manager' of that company for the period between 1 April 1997 and 31 March 1998 amounting in total to $1,738,285. No part of the salary was stated as having been paid by Company A-Singapore as 'an overseas concern' in the space reserved for the purpose. Company A-Hong Kong still provided quarters to the Appellant in the First Villa F Flat. That return was signed by the Appellant as the 'General Manager' of that company.

11. The Appellant had to travel extensively in the course of his work. He had to obtain the prior approval of Mr B in relation to his travelling arrangements. Mr B retired in June 1998. He was succeeded by Mr H who was appointed a director of Company A-Hong Kong on 30 June 1998. Mr H exercised similar supervision on the Appellant.

12. By an employer's return dated 20 April 1999 ('the 99 Return'), Company A-Hong Kong informed the Revenue that the salary and commission earned by the Appellant for the year ended 31 March 1999 amounted to $2,009,488. As in the two previous returns, no part of the salary was stated as having been paid by Company A-Singapore as 'an overseas concern' in the space reserved for the purpose. Another flat in Villa F ('the Second Villa F Flat') was provided by Company A-Hong Kong to the Appellant as his quarters. The Appellant signed the 99 Return as the 'General Manager' of Company A-Hong Kong.

13. The wages depicted in the 97, the 98 and the 99 Returns were paid by Company A-Hong Kong into a bank account of the Appellant in Hong Kong.

Case of the Appellant

14. In his tax returns - individuals for the years of assessment 1996/97 to 1998/99, the Appellant claimed that Company A-Singapore was his employer and only part of his income from Company A-Singapore attributable to services rendered in Hong Kong should be assessed to salaries tax. The Appellant sought to apportion his income by reference to the number of days which he spent in Hong Kong. He spent 200 days in Hong Kong for the year of assessment 1996/97; 304 days for the year of assessment 1997/98 and 313 days for the year of assessment 1998/99.

15. Reliance is placed on the Revenue's Practice Note.

(a) Paragraph 3 of the Practice Note states that:

'*As a consequence of the* ***Geopfert*** *decision and the observations contained in the judgment the Department will in future accept, subject to the qualification at paragraph 6, that an employment is located outside Hong Kong, in other words that a "non-Hong Kong" employment exists, where the following three factors are present, namely –*

(a) the contract of employment was negotiated and entered into, and is enforceable outside Hong Kong;

(b) the employer is resident outside Hong Kong; and

(c) the employee's remuneration is paid to him outside Hong Kong.'

(b) Paragraph 5 of the Practice Note states that:

'*There will, of course, be cases where not all three factors are satisfied by a person claiming to have a no-Hong Kong employment. Such cases will continue to be considered on their merits but, generally speaking, the Department would regard the existence of an overseas contract with a non-resident employer as outweighing the payment of remuneration in Hong Kong.*'

The Appellant argued that his employer is Company A-Singapore and his contract of employment with Company A-Singapore was negotiated and entered into outside Hong Kong. Given the

Revenue's stance as embodied in paragraph 5 of the Practice Note, his tax position is therefore regulated by section 8(1A) as opposed to section 8 of the IRO.

16. In correspondence with the Revenue, the Appellant further asserted that:

> 'The fact that [the Appellant's] remuneration was ultimately borne by [Company A-Hong Kong] is not relevant to determine the source of employment. An employment is a master and servant relationship. This relationship cannot be created between [the Appellant] and [Company A-Hong Kong] as a result of [Company A-Hong Kong] being charged by [Company A-Singapore]. As each company in a group is a profit centre, charging on services provided among group companies is very common practice'.

Case of the Revenue

17. The Revenue drew our attention to CIR v Goepfert 2 HKTC 210 at 237 where Macdougall J stated that:

> '*Specifically, it is necessary to look for the place where the income really comes to the employee, that is to say, where the source of income, the employment, is located. As Sir Wilfrid Greene said, regard must first be had to the contract of employment.*
>
> *This does not mean that the Commissioner may not look behind the appearances to discover the reality. The Commissioner is not bound to accept as conclusive, any claim made by an employee in this connexion. He is entitled to scrutinise all evidence, documentary or otherwise, that is relevant to this matter*'.

18. The Revenue submits that the Commissioner is not bound by the Offer Letter as accepted by the Appellant as conclusive on the issue. The Revenue further submits that the Appellant was in substance appointed general manager of Company A-Hong Kong. The Revenue invites this Board to infer that on the facts any contract between Company A-Singapore and the Appellant was varied with Company A-Hong Kong taking the place of Company A-Singapore.

The law

19. The question posed by section 8(1) of the IRO is this: is the income derived from Hong Kong from a source of employment or is it not [CIR v Goepfert (above cited) at page 234]?

20. The key element to be identified is the source of income as opposed to the location of employment [D79/97, IRBRD, vol 12, 461].

21. The place where the services are rendered is not relevant to the inquiry under section 8(1) as to whether income arises in or is derived from Hong Kong from any employment. It should be completely ignored [CIR v Goepfert (above cited) at page 236].

22. The Board must look at all relevant facts but disregard the place where the services were rendered in determining the source of income [D40/90, IRBRD, vol 5, 306 at 313].

23. There is no justification for the three tests as promulgated by the Commissioner in the Practice Note. It is contrary to the 'totality of facts test' set out by Macdougall J in CIR v Goepfert to say that if a taxpayer complies with the three tests he is not taxable in Hong Kong [D40/90, IRBRD, vol 5, 306].

Our decision

24. The Revenue's case is based largely on the three employer's returns signed by the Appellant as general manager of Company A-Hong Kong and the fact that such payments were classified as 'Director's fee' in the audited accounts of Company A-Hong Kong for the relevant years of assessment. At the conclusion of the first session of hearing before us on 30 November 2002, we expressly invited the Appellant for additional assistance on these points.

25. The Appellant drew our attention to section 52(3) of the IRO whereby a director is deemed a person employed by a company for the purpose of submission of return in respect of remuneration paid to such employee. We do not find such explanation adequate or sufficient. Section 52(3) merely includes director of a company as employee for the purpose of submission of a return. That subsection does not impose any obligation to report any remuneration when in truth no such remuneration had been paid to the director in question. Furthermore the returns were in respect of earnings paid to the Appellant as general manager.

26. In order to tackle the concerns that we expressed, the Appellant tendered two statements. The first statement is from Mr I, finance director of Company A-Hong Kong. Mr I explained that the payments to the Appellant were 'mistakenly classified' as 'Director's fee'. The same mistake was repeated in the employer's returns. From 2000 onwards, the amount was classified under 'Other emoluments'. Mr I further asserted that Company A-Hong Kong was reimbursed by Company A-Singapore in respect of the salaries paid to the Appellant by setting-off. The second statement tendered by the Appellant is from a director of Company A-Singapore. According to this latter statement, Company A-Singapore 'employed [the Appellant] since July 24, 1996 and the contractual obligations with his employment contract are still borne by [Company A-Singapore]'. No attempt was made by these deponents to tender any primary evidence in support of their assertions. Had the Appellant been part of the work force of Company A-Singapore, one would expect that fact to be reflected in the books of account of Company A-Singapore and in correspondence between Company A-Singapore or the Appellant with the

Singapore fiscal authority. The Appellant did not tender these two deponents for cross-examination. In these circumstances, we are not prepared to attach any weight to their statements.

27. The Appellant hotly disputes the existence of any contractual nexus between himself and Company A-Hong Kong. He says in evidence that the employer's returns were signed by him in his capacity as general manager of Company A-Hong Kong and they do not constitute evidence of his personal assent to any variation of his employment contract with Company A-Singapore. We are of the view that the issue is one of contractual intention and the relevant test to be applied is an objective test. The objective facts are these:

(a) There is no evidence before us of any payment by Company A-Singapore of any salary in favour of the Appellant. No attempt was made by the Appellant to demand such payment from Company A-Singapore.

(b) There is no evidence whereby Company A-Singapore or the Appellant held themselves out to the outside world that an employment relationship subsisted between them as from 24 July 1996.

(c) Company A-Hong Kong represented to the Revenue that the Appellant was employed by them as general manager as from 24 July 1996 and further represented that Company A-Hong Kong paid the Appellant salary and provided the Appellant with quarters in respect of such employment. At no time did Company A-Hong Kong state that the Appellant was paid by an overseas concern. The Appellant knew of these representations given the fact that he signed the returns as Company A-Hong Kong's general manager. The Appellant took no step to disavow these representations as being inaccurate.

(d) The Appellant however sought Mr B's approval in relation to his travel arrangements. It was Company A-Singapore who notified the Appellant of any change in his base salary.

28. We have reminded ourselves that our task is to identify the source of the Appellant's income and to look for the place where the income really comes to the Appellant. We have to determine this question as a matter of reality.

29. We take the view and we so find that the initial involvements of the head office of Company A and Company A-Singapore was to locate someone to take charge of the operations headed by Company A-Hong Kong. It was agreed between Company A-Singapore, Company A-Hong Kong and the Appellant that as from 24 July 1996, the Appellant should be employed by Company A-Hong Kong as its general manager and be remunerated as such in Hong Kong. As the Appellant's services were rendered in favour of Company A-Hong Kong, his salaries became part

of the outgoings of Company A-Hong Kong and the audited accounts were prepared on that basis. For like reason, Company A-Hong Kong reported to the Revenue the salary they paid to the Appellant. Company A-Singapore continued to play a role in the relationship between Company A-Hong Kong and the Appellant because Company A-Singapore exercised a supervisory role in the performance of Company A-Hong Kong as part of the international set-up of Company A.

30. On this basis, we are of the view that the Appellant's income arose in or was derived from his employment as general manager of Company A-Hong Kong and he was correctly assessed as such. We dismiss the Appellant's appeal.