Case No. D146/98

Salaries Tax – employment – place of service – 60 days limit – whether liable to salaries tax.

Panel: Andrew Halkyard (chairman), Mathew Ho Chi Ming and William Zao Sing Tsun.

Date of hearing: 8 December 1998.
Date of decision: 13 January 1999.

On 15 September 1996 the taxpayer commenced employment with Company A as an after sales manager in the office in City C, China of the Joint Venture. Some time before the taxpayer started work in City C, a large extent to which the conditions of employment were settled in Hong Kong. The taxpayer arrived in City C and started work on 16 September 1996. On 15 October 1996, an employment contract was signed between the taxpayer and two co-presidints of the Joint Venture.

During the period from 15 September 1996 to 31 March 1997, the taxpayer, a permanent resident of Hong Kong, spent more than 60 days in Hong Kong and carried out employment duties in Hong Kong for only one day. The scope of the Joint Venture's business was totally separated from that of the Hong Kong Company. The taxpayer's salary under the contract signed with the Hong Kong Company was paid to him by the Hong Kong Company into his bank account in Hong Kong.

The Hong Kong Company submitted an employer's return to the Inland Revenue department in respect of the taxpayer for the year of assessment 1996/97 and the Hong Kong Company stated, in response to the assessor's enquiry, that the taxpayer has not rendered any services to company in Hong Kong. The assessor considered that the taxpayer did not render all his service outside Hong Kong and that he stayed in Hong Kong for more than 60 days during the year of assessment 1996/97. The Commissioner confirmed the assessor's view and considered that the source of the taxpayer's income was not in issue. The taxpayer appealed on the ground that his income is wholly referable to service outside Hong Kong for a non-Hong Kong employer and therefore his income should not be assessed to salaries tax.

Held:

(1) Based on the evidence before the Board, the Board rejected the Commissioner's argument that the taxpayer entered into so-called split contracts, under which remuneration and duties were apportioned between Hong Kong and China employers. The Board accepted the taxpayer's

evidence and was satisfied that this is not a case of a taxpayer with dual contract responsibilities both in Hong Kong and China. Apart from the role of paymaster, the Hong Kong Company appeared to have no role in the taxpayer's employment.

(2) The Board must determine the location of the taxpayer's employment to decide the source of his employment income. Looking broadly at all the relevant facts, the Board concluded that the taxpayer had one contract of employment with the Joint Venture and that this was located outside Hong Kong (CIR v Goepfert (1987) 2HKTC 210 applied).

(3) The Board found that the taxpayer's employment contract was not motivated by tax considerations and this is not a case where a locally-engaged employee has simply entered into a contract of employment with an offshore employer without changing the underlying status of a Hong Kong employment. Rather, this is a case where the Hong Kong Company simply acted as paymaster for the taxpayer to undertake an offshore employment with the Joint Venture (D20/97, IRBRD, vol 12, 161 distinguished).

(4) The Board concluded that the taxpayer's employment was not located in Hong Kong and the taxpayer is only subject to salaries tax under section 8(1A) on the income referable to one day's service rendered to his employer, the Joint Venture, in Hong Kong during October 1996 (D47/97, IRBRD, vol 12, 313 considered).

Appeal allowed in part.

Cases referred to:

CIR v Goepfert (1987) 2 HKTC 210
D20/97, IRBRD, vol 12, 161
D47/97, IRBRD, vol 12, 313

Yim Kwok Cheong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. The Taxpayer has appealed against the determination of the Commissioner in relation to a salaries tax assessment raised on him for the year of assessment 1996/97. The Taxpayer claims that his income is wholly referable to services outside Hong Kong for a non-Hong Kong employer and therefore his income should not be assessed to salaries tax.

The facts

2. We state, at the outset, that the evidence surrounding the Taxpayer's employment was somewhat complex. In any event, it was quite different from the documents available to the Commissioner when he rejected the Taxpayer's objection to the assessment.

3. Our findings of fact are as follows. They are based upon various exchanges of correspondence initiated by the Inland Revenue Department as well as the oral and documentary evidence adduced by the Taxpayer.

1. The Taxpayer has been working in the forklift truck industry for almost ten years. For the past eight years, he operated his own business in Hong Kong. This firm specialises in selling and servicing forklift and pallet moving machinery.

2. Company A, whose headquarters are in Country B, has a subsidiary incorporated and carrying on business in Hong Kong ('the Hong Kong Company'). It also has an interest in a joint venture in China ('the Joint Venture').[1]

3. On 15 September 1996 the Taxpayer commenced employment with Company A. He was recruited to work as an after sales manager in the office in City C, China of the Joint Venture. He arrived in City C and started work on 16 September 1996. Details surrounding the negotiation and execution of his employment contract, and the conditions thereof, are set out below.

4. Some time before he started work in City C, an executive of Company A initiated contact with the Taxpayer and asked whether he would accept the post of after sales manager in the office of the Joint Venture in City C. Although we were not told the extent to which the conditions of employment were settled before the Taxpayer arrived in City C, we assume that, to a large extent, they were discussed and agreed in Hong Kong. We assume this because on the date the Taxpayer commenced work in City C, 16 September 1996, the Hong Kong Company faxed a

[1] Under the law of Mainland China, a joint venture (whether an equity or a co-operative joint venture) is a Chinese legal entity.

document entitled 'contract of employment' to the office of the Joint Venture. Mr D, the manager of the Joint Venture's office, had previously discussed certain details of this contract with the Taxpayer. The contract was signed on behalf of the Hong Kong Company by Mr E on 5 September 1996. The Taxpayer signed this contract on 15 October 1996 (see fact 6).

5. The contract entered into between the Taxpayer and the Hong Kong Company was embodied in a very short document, being slightly longer than one page. It described the employer as the Hong Kong Company, the Taxpayer's position as 'manager after sales, City C' and set out his basic remuneration and allowances. Other conditions related to matters such as probation period, hours of work and reimbursement of expenses (both of these clauses referred to the regulations imposed by the Joint Venture), leave periods, confidentiality and secrecy.

6. When he arrived in City C, the Taxpayer was also given the draft of another contract entitled 'employment contract (long term)'. This contract stated that the employer was the Joint Venture. Initially, the Taxpayer did not sign the contract because there were two matters to which he objected. These related to the term of the restrictive trade covenant placed on him after termination of the contract. In the event, the Taxpayer agreed with the Joint Venture that the term of this restrictive covenant be reduced from five years to one year. The Taxpayer then signed the revised contract on 15 October 1996, the same date that he signed the document described at facts 4 and 5. The contract was also signed on behalf of the Joint Venture by a senior executive of China joint venturer and Mr E. Both gentlemen were co-presidents of the Joint Venture. Mr D also initialled the contact.[2]

7. The contract entered into between the Taxpayer and the Joint Venture, although also a short document, was more detailed than the contract described at facts 4 and 5. It described the employer as the Joint Venture, stated that the Taxpayer was employed with effect from 15 September 1996 by the Joint Venture's sales office in City C and that his duties were to provide 'after-sale managerial service'. Under the contract the Joint Venture reserved the right to transfer the Taxpayer to any post within the Joint Venture, including assigning him work outside China, as it saw fit. Other provisions covered by the contract included the Taxpayer's basic remuneration, which amounted to RMB3,000 per month,[3] probation period, labour insurance, hours of work, holidays and leave, restraint of trade and confidentiality, and a labour dispute mechanism.

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[2] See also fact 4.

[3] Neither the Taxpayer nor the Hong Kong Company reported this remuneration to the IRD.

8. During the period from 15 September 1996 to 31 March 1997, the Taxpayer, a permanent resident of Hong Kong, spent more than 60 days in Hong Kong. His pregnant wife lived in Hong Kong. He returned to Hong Kong on most weekends and public holidays.

9. During the period from 15 September 1996 to 31 March 1997, the Taxpayer carried out employment duties in Hong Kong for only one day. Specifically, before returning to City C after spending a weekend in Hong Kong in late October, he purchased an electrical plug for use by the Joint Venture's office in City C. This part was easy to obtain in Hong Kong but difficult to purchase in China. Apart from this isolated instance, the rest of his employment duties during the period were carried out in China.

10. The scope of the Hong Kong Company's business is to sell forklift trucks and pallet (or warehouse) trucks manufactured by Company A in overseas countries. The Hong Kong Company also carried out after sales service and sold spare parts. All its customers were located in Hong Kong. It had no office or branch in City C.

11. The scope of the Joint Venture's business was totally separate from that of the Hong Kong Company. Specifically, it sold forklift trucks manufactured by it in China. It also provided after sales and maintenance services for its customers. All its customers were located in China. It had offices or branches in several cities, including City C.

12. The Hong Kong Company submitted an employer's return to the Inland Revenue Department in respect of the Taxpayer for the year of assessment 1996/97. This return stated that the Taxpayer was employed as manager after sales for the period 15 September 1996 to 31 March 1997, that he received remuneration from employment of $217,815, and that his address was City C, China. The remuneration, consisting of salary and allowances, was based exactly upon his contractual entitlements referred to at fact 5.

13. Subsequently, in response to the assessor's enquiry, the Hong Kong Company stated:

> "[The Taxpayer] has not rendered any services to our company in Hong Kong."

14. The Taxpayer's salary under the contract signed with the Hong Kong Company was paid to him by the Hong Kong Company into his bank account in Hong Kong. The Taxpayer's salary under the contract signed with the Joint Venture was paid to him by the Joint Venture in City C.

15. The Taxpayer was provided by the Joint Venture with a business card. On that card he was described as 'after sales department manager' of the Joint Venture, City C. No reference to any other entity appeared on this card, apart from the corporate logo.

16. The assessor considered that the Taxpayer did not render all his services outside Hong Kong and that he stayed in Hong Kong for more than 60 days during the year of assessment 1996/97. The assessor thus raised a salaries tax assessment on the Taxpayer for the year of assessment on the basis of the income disclosed at fact 12.

17. The Commissioner rejected the Taxpayer's objection to the assessment. He confirmed the assessor's view at fact 16. He considered that the source of the Taxpayer's income was not in issue.

18. The Taxpayer lodged a valid appeal to the Board of Review against the Commissioner's determination. He claimed that he had no service relationship with the Hong Kong Company and that he never even visited this company. Although admitting that he spent one day in Hong Kong purchasing spare parts for the office of the Joint Venture in City C, he maintained that he rendered no service inside Hong Kong.

19. Referring to the contract with the Hong Kong Company (facts 4 and 5), the Taxpayer contended that it was simply entered into for the purpose of paying his salary and allowances. He noted, rhetorically, that if he were not paid this remuneration, then he would only be paid RMB3,000 per month under his contract with the Joint Venture and that to only work for this latter amount would beggar belief. The Taxpayer explained this remuneration 'split' as follows. It was important to ensure that his visible salary in China was comparable with that paid to his equivalent China colleagues working in the Joint Venture. In this regard, he noted that China colleagues nominally senior to him were only paid RMB4,000 per month. Living standards were, however, different for China and Hong Kong recruited staff. For all these reasons, his total remuneration could not be wholly paid by the Joint Venture.

The contentions for the Taxpayer

4. The Taxpayer claimed that as a matter of both law and substance, his employer was the Joint Venture. He claimed that the Hong Kong Company did not employ him. In this regard, he noted that his Hong Kong business carried on the same type of business as that carried on by the Hong Kong Company (compare facts 1 and 10). He contended that if the employment relationship were that stated by the Commissioner, this would give rise to a conflict of interest which would not have been tolerated by the Hong Kong Company. He then noted that the contract he signed with the Hong Kong Company did not contain any

restrictive trade covenant applying after termination of employment. By way of contrast, the contract he signed with the Joint Venture did contain such restrictions.

5. The Taxpayer buttressed his argument by noting that his duties had nothing to do with the business of the Hong Kong Company; indeed, this business was totally separate from the business of the Joint Venture – which focused solely on Hong Kong and China customers respectively (facts 10 and 11 refer). He also drew our attention to his name card to show that he worked in a designated post for the Joint Venture and only in China (fact 15 refers).

The statutory provisions and their interpretation

6. Section 8 of the Inland Revenue Ordinance provides:

> *'(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 …*
>
> *(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; …*
>
> *(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.'*

7. These provisions were considered in CIR v Goepfert (1987) 2 HKTC 210, where Macdougall J stated at 236 – 237:

> *'… the place where the services are rendered is not relevant to the enquiry under section 8(1) as to whether income arises in or is derived from Hong Kong from any employment. It should therefore be completely ignored.*
>
> *That being so, what is the correct approach to the enquiry? … 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 Wilfred Greene said, regard must first be had to the contract of employment.'*

8. We note that Inland Revenue Departmental Interpretation & Practice Notes No 10: 'The Charge to Salaries Tax' (revised, 1 December 1987), paragraph 6 states:

> *'It is expected that in the great majority of cases the question of Hong Kong or non-Hong Kong employment will be resolved by considering only the three factors [namely, the place where the contract of employment was negotiated, entered into and enforceable; the residence of the employer; and the place of payment of the remuneration]. However, the Department must reserve the right, in appropriate cases, to look beyond those factors. As was pointed out in the Goepfert decision:*
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> > *'There can be no doubt therefore that in deciding the crucial issue, the Commissioner may need to look further than the external or superficial features of the employment. Appearances may be deceptive. He may need to examine other factors that point to the real locus of the source of income, the employment.'*
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> *The situations in which further factors will have to be examined cannot be laid down with precision. However, cases where a person changes his employment from an employer resident in Hong Kong to one resident outside Hong Kong with little apparent change in the nature of duties performed will be given careful scrutiny. Similar attention will be given to cases where locally-engaged employees enter into offshore contracts of employment.'*

The main issue before us and the Commissioner's contentions

9. One of the difficulties in this case is that the Taxpayer (a layman who represented himself) essentially argued his appeal on a different basis from his objection considered by the Commissioner. While the Commissioner's representative focused mainly upon the applicability of the so-called 60-day rule (compare facts 16 and 17), the Taxpayer's main contention before us was that he was not employed by the Hong Kong Company and that, in any event, he did not render any service in Hong Kong.

10. In the circumstances, we consider that we must first establish whether the Taxpayer's income was derived from a Hong Kong employment (in which case it must be fully subject to salaries tax under section 8(1), unless the 60-day rules applies[4]) or a non-Hong Kong employment (in which case it is subject to salaries tax under section 8(1A) only in respect of income derived from services rendered in Hong Kong, again unless the 60-day rule applies).

Analysis

11. The factors showing a Hong Kong employment are that (1) the Taxpayer signed a document entitled 'contract of employment' with the Hong Kong Company, (2)

[4] It was never suggested that section 8(1A)(c) applied in this case.

negotiation of certain terms of his contract took place in Hong Kong and (3) he was paid, in the main, by the Hong Kong Company in Hong Kong. At face value, these factors are highly significant and must be given due weight. But, on the facts before us, each of these factors has a China counterpart showing a non-Hong Kong employment. We will deal with each of these separately.

12. In relation to factor (1), the Taxpayer also signed a contract of employment with the Joint Venture for the same post. Although the Commissioner 's representative tried, albeit tentatively, to persuade us that the Taxpayer entered into so-called spit contracts, under which remuneration and duties were apportioned between Hong Kong and China employers, the evidence before us simply did not support this conclusion. In reality, the Taxpayer had one employment with two paymasters. We will say more of this when we consider factor (3). It follows that we reject the Commissioner's argument before us "That the Taxpayer might have entered into a separate contract with [the Joint Venture] and received the monthly wage of RMB3,000 is not of much relevance … for the purpose of the present appeal.'

13. In relation to factor (2), negotiation of key terms of that contract relating to the restraint of trade clauses took place in China. The Taxpayer also signed the contract in China.

14. Finally, consideration of factor (3) best shows the reality of the Taxpayer's employment because we accept the Taxpayer's evidence and find as fact that his contract with the Hong Kong Company was simply entered into for the purpose of having a non-China paymaster (fact 19 refers). The Taxpayer's evidence on this matter had the stamp of truth and was not challenged in cross-examination. It was also supported by all other relevant facts. Specifically, the Taxpayer was recruited to work in China for a mainland legal entity. He had a designated post with that entity. He had no designated post with the Hong Kong Company. The contractual documents relate to one and the same post. The contract entered into with the Joint Venture was more detailed and covered a far wider scope (including the restraint of trade provisions pressed upon us by the Taxpayer) than the document signed by the Taxpayer and the Hong Kong Company. There is no evidence before us that the Hong Kong Company had any business relationship with the Joint Venture, apart from belonging to the same offshore corporate group. Indeed, the business of the Hong Kong Company is totally separate from that of the Joint Venture. This is not a case of a taxpayer with dual contract responsibilities both in Hong Kong and China. There is no evidence that after his recruitment the Taxpayer had any contract, reporting or otherwise, with the Hong Kong Company. In short, apart from the role of paymaster, the Hong Kong Company appeared to have no role in the Taxpayer's employment.

15. Applying Goepfert's case, we appreciate that we must determine the location of the Taxpayer's employment to decide the source of his employment income. In this regard, we have not considered the place where the Taxpayer's services were rendered. Instead, looking broadly at all the relevant facts, with particular emphasis upon those highlighted above, we have no hesitation in concluding that the Taxpayer had one contract of employment with the Joint Venture and that this was located outside Hong Kong.

16. Similar to the previous Board case, D 20/97, IRBRD, vol 12, 161, we wish to make clear that we should not be taken as disputing the Commissioner's statement in Departmental Interpretation & Practice Notes No 10 that in the great majority of cases the location of an employment will be resolved by considering only the three factors mentioned therein. However, as the Commissioner recognises, in appropriate cases it is necessary to look beyond those factors. In this case, there is absolutely no suggestion that the Taxpayer's employment contract with the Joint Venture was motivated by tax considerations. And, unlike D 20/97, this is not a case where a locally-engaged employee has simply entered into a contract of employment with an offshore employer without changing the underlying status of a Hong Kong employment. Rather, this is a case where the Hong Kong Company simply acted as paymaster for the Taxpayer to undertake an offshore employment with the Joint Venture.

17. We note that we fully understand the Commissioner's approach to this case. Until the issue of the location of the Taxpayer's contract of employment crystallised at the Board hearing, all the Taxpayer's arguments were based upon the application of the 60-day rule and whether he rendered any services in Hong Kong. It is not surprising, therefore, that the Commissioner's representative was taken somewhat by surprise at the hearing. Be that as it may, the Taxpayer's appeal raised the wider issue of whether he was subject to salaries tax at all. As indicated above, we have concluded that the Taxpayer's employment was not located in Hong Kong.

18. In conclusion, the Taxpayer is only subject to salaries tax under section 8(1A) on the income referable to one day's service rendered to his employer, the Joint Venture, in Hong Kong during October 1996. In this regard, we agree with the Commissioner that the 60-day rule does not assist the Taxpayer. Specifically, the Taxpayer spent more than 60 days in Hong Kong in the year of assessment 1996/97 and he carried out some, albeit minuscule, service in Hong Kong for the Joint Venture (compare, albeit in relation to a Hong Kong employment, D 47/97, IRBRD, vol 12, 313).

19. We order that the assessment should be reduced in accordance with the conclusion reached in the previous paragraph. Either party is at liberty to approach the Board if the basis of assessment cannot be agreed.