

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D17/04

Salaries tax – whether sum received by appellant was excluded from salaries tax under section 8(1A)(c) of the Inland Revenue Ordinance ('IRO') – proper approach in determining whether sums are excluded as being subject to tax in a foreign jurisdiction – must prove that foreign tax was in respect of services rendered overseas.

Panel: Ronny Wong Fook Hum SC (chairman), Choi Kin and Daisy Tong Yeung Wai Lan.

Date of hearing: 29 January 2004.

Date of decision: 8 June 2004.

By a memorandum dated 16 May 1994, the appellant confirmed his employment with Company A and was entitled to receive both a basic salary and a hardship allowance in respect of services rendered in the PRC. Both his salary and hardship allowance were paid by Company A (a Hong Kong company) in Hong Kong although he worked as the assistant general manager of Company B-Shenzhen (a PRC company) and spent a significant amount of time in the PRC.

The appellant claimed that during the year of assessment 1998/99 a total of HK\$690,040 was exempt for salaries tax under section 8(1A)(c) of the IRO on the basis that the sum was already subject to salaries tax in the PRC.

To support his contention, the appellant placed reliance on the regulations contained in the Notice promulgated by the Fiscal Authority in the PRC on 30 June 1994 in relation to the imposition of salaries tax earned by an individual who has no residence in the PRC.

The issue in the appeal was the extent to which the appellant is entitled to claim exclusion of his income from salaries tax assessment for the year of assessment 1998/99 by virtue of section 8(1A)(c) of the IRO.

Held:

1. The source of the appellant's income was located in Hong Kong since his employment contract was made with a Hong Kong entity carrying on business in Hong Kong and he was paid in Hong Kong. His income was therefore chargeable to salaries tax subject to the application of the exclusions under sections 8(1A)(b)(ii) and 8(1A)(c) of the IRO.

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2. Further, the exclusion under section 8(1A)(b)(ii) of the IRO was inapplicable because the appellant spent more than 60 days in Hong Kong and rendered services during his visits.
3. As to the exclusion under section 8(1A)(c), following the approach in D34/01, in order to qualify for an exemption under section 8(1A)(c) of the IRO three requirements must be satisfied which are as follows (i) the taxpayer derived income from services overseas; (ii) the income was chargeable to tax of a similar nature to salaries tax; and (iii) the Commissioner is satisfied that the person has paid tax of that nature in that territory in respect of the income.
4. The meaning and intent of section 8(1A)(c) is to allow a person to deduct from his income assessable to Hong Kong salaries tax which has been taxed elsewhere.
5. The appellant was assessed in the PRC under Regulation 3 which did not attach to the earnings of the appellant whilst working outside the PRC.
6. On the facts, the appellant had failed to prove that the entirety of HK\$690,040 was income derived by the appellant from services rendered by him in the PRC. The appellant could only establish that HK\$520,934 fell within the exclusion under section 8(1A)(c) as the outstanding sum was derived from services rendered in Hong Kong.

Appeal dismissed.

Case referred to:

D34/01, IRBRD, vol 16, 303

Ngan Man Kuen for the Commissioner of Inland Revenue.

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Taxpayer in person.

Decision:

1. The issue in this appeal is the extent to which the Appellant is entitled to claim exclusion of his income from salaries tax assessment for the year of assessment 1998/99 by virtue of section 8(1A)(c) of the Inland Revenue Ordinance [‘IRO’].

2. Company A, Company B-Hong Kong and Company B-Shenzhen are associated companies. Company A and Company B-Hong Kong are companies incorporated and carrying on business in Hong Kong whilst Company B-Shenzhen is a company incorporated and carrying on business in Shenzhen.

3. By a memorandum dated 16 May 1994, Company B-Hong Kong confirmed the employment of the Appellant on the following terms and conditions:

- (a) ‘Basic salary: Employee shall receive a monthly basic salary of HK\$28,300 payable on the last day of every month’.
- (b) ‘Special allowance: An allowance of HK\$12,807 shall be paid monthly in addition to the basic salary on the last day of every month or at such rate of allowance may be adjusted from time to time at the discretion of the company’.
- (c) ‘Condition subsequent: In the event that the employee is required to perform the service in the workplace other than China or to render service to the company in Hong Kong permanently, the special allowance agreed in this memo shall at once cease and become null and void’.

4. The Appellant had in fact been working as the assistant general manager of Company B-Shenzhen since August 1993. According to a certificate from Company B-Shenzhen dated 1 November 1999:

- (a) the Appellant’s salary including his hardship allowance for working in China were paid by Company A in Hong Kong.
- (b) The Appellant had to report to a Mr C who was the general manager of Company A and Company B-Shenzhen and the group director of Company B-Hong Kong. The office of Mr C was at Company A.

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5. By a return dated 20 May 1999, Company A reported to the Revenue the following earnings of the Appellant for the year ended 31 March 1999:

Salary/wages	\$518,666
Hardship allowance	<u>\$216,720</u>
<u>Total</u>	<u>\$735,386</u>

These figures were reflected in the Appellant's own return for 1998/99 dated 28 May 1999.

6. The Appellant's contract of employment was made with a Hong Kong entity carrying on business in Hong Kong. The Appellant was paid in Hong Kong. We find that the source of his income, the employment, was located in Hong Kong. His income is therefore within section 8(1) of the IRO subject to the application of the various exclusions under section 8(1A)(b)(ii) and 8(1A)(c) of that Ordinance.

7. As far as the exclusion under section 8(1A)(b)(ii) is concerned, there was little dispute between the parties that the Appellant spent more than 60 days in Hong Kong in the year 1998/99 and that he did render services in Hong Kong during his visits. The exclusion under section 8(1A)(b)(ii) is therefore inapplicable.

8. As far as the exclusion under section 8(1A)(c) is concerned,

- (a) the Appellant maintained that \$690,040 should be excluded from salaries tax assessment leaving only \$45,346 [$\$735,386 - \$690,040$] as his assessable income. He relies on the assessments made by the Shenzhen fiscal authority computed in the manner as outlined in Schedule I annexed hereto.
- (b) the Appellant also placed reliance on the regulations ['the Regulations'] in the Notice promulgated by Fiscal Authority in China on 30 June 1994 ['the Notice'] in relation to salaries earned by an individual who has no residence in China.
 - (i) Regulation 1 makes it clear that the salary earned by an individual actually working in China should be regarded as salaries sourced in China. This is so irrespective of the fact that the salary was paid by an individual or corporate employer stationed within or outside China.
 - (ii) Regulation 3 governs the position of an individual who has no residence in China but who resides continuously or cumulatively in China for more than 90 days or who resides pursuant to a fiscal agreement continuously or cumulatively in China for more than 183 days but not more than a year. Such individual has to report and pay income tax in respect of salary

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earned during the period actually working within China irrespective of the fact that such salary may have been paid by an individual or corporate employer located in China or outside China. Save for situation within Regulation 5, no income tax is assessed on salary earned during the period whilst working outside China.

- (iii) Regulation 5 is applicable to an individual who is a director or who is within the senior management of an enterprise in China. For such an individual, Regulation 3 is inapplicable to the director's fees or salary paid by that enterprise within China and the same are assessable to income tax from inception to termination of his appointment irrespective of the question whether such individual carries out his duties within or outside China.

9. The Revenue contended as follows:

- (a) D34/01, IRBRD, vol 16, 303 makes it clear that to qualify for an exemption under section 8(1A)(c) of the IRO, there are three requirements namely:

- (i) that the taxpayer derived income from services overseas;
- (ii) that the income was chargeable to tax of a similar nature to salaries tax and
- (iii) that the Commissioner is satisfied that the person has paid tax of that nature in that territory in respect of the income.

- (b) As further pointed out by this Board in D34/01

'...when construing section 8(1A)(c), we should bear in mind that the meaning and intent of section (1A)(c) is to allow a person to deduct from his income assessable to Hong Kong salaries tax that part of his income which has been taxed elsewhere'.

- (c) The Appellant failed to prove that \$690,040 was 'income derived by [the Appellant] from services rendered by him' in China.
- (d) According to Company A, one-third of the hardship allowance was reported to the fiscal authority in China as part of the wages in China whilst two-third of the hardship allowance was reported to that authority as part of the wages outside China. The sum of \$690,040 was made up as follows:

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Month	Hardship allowance	Salary in China	Salary outside China	Total
4-1998	\$18,060	\$13,980	\$23,080	\$55,120
5-1998	\$18,060	\$13,980	\$23,080	\$55,120
6-1998	\$18,060	\$13,980	\$25,940	\$57,980
7-1998	\$18,060	\$13,980	\$25,940	\$57,980
8-1998	\$18,060	\$13,980	\$25,940	\$57,980
9-1998	\$18,060	\$13,980	\$25,940	\$57,980
10-1998	\$18,060	\$13,980	\$25,940	\$57,980
11-1998	\$18,060	\$13,980	\$25,940	\$57,980
12-1998	\$18,060	\$13,980	\$25,940	\$57,980
1-1999	\$18,060	\$13,980	\$25,940	\$57,980
2-1999	\$18,060	\$13,980	\$25,940	\$57,980
3-1999	\$18,060	\$13,980	\$25,940	\$57,980
	\$216,720	\$167,760	\$305,560	\$690,040

- (e) Whilst \$216,720 by way of hardship allowance and \$167,760 by way of salary in China were income derived by the Appellant from services rendered by him in China, the sum of \$305,560 was income derived by him from services rendered both in China and in Hong Kong. The same should be apportioned on a day-in day-out basis as follows:

Month	Salary outside China	That part of the salary outside China derived by the Appellant from services rendered by him in China		That part of the salary outside China derived by the Appellant from service rendered by him in Hong Kong	
		No of days in China	Amount	No of days in Hong Kong	Amount
4-1998	\$23,080	17	\$13,079	13	\$10,001
5-1998	\$23,080	16	\$11,912	15	\$11,168
6-1998	\$25,940	20	\$17,293	10	\$8,647
7-1998	\$25,940	15	\$12,552	16	\$13,388
8-1998	\$25,940	14	\$11,715	17	\$14,225
9-1998	\$25,940	11	\$9,511	19	\$16,429
10-1998	\$25,940	14	\$11,715	17	\$14,225
11-1998	\$25,940	3	\$2,594	27	\$23,346

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12-1998	\$25,940	11	\$9,205	20	\$16,735
1-1999	\$25,940	15	\$12,552	16	\$13,388
2-1999	\$25,940	10	\$9,264	18	\$16,676
3-1999	\$25,940	18	\$15,062	13	\$10,878
	\$305,560	164	\$136,454	201	\$169,106

- (f) Only \$520,934 is within the exclusion under section 8(1A)(c) made up as follows:

Hardship allowance	\$216,720
Salary in China	\$167,760
Part of the salary in Hong Kong	<u>\$136,454</u>
<u>Total</u>	<u>\$520,934</u>

10. We are of the view that the Revenue is correct in its contentions.

- (a) We do not see the relevance of Regulation 5 of the Notice. That Regulation is only applicable if the director's fees or the wages were paid by the enterprise in China. Company B-Shenzhen did not pay the Appellant. At all material times, the Appellant was paid by Company A in Hong Kong.
- (b) The Appellant was assessed in China under Regulation 3. Liability under that Regulation attaches to earnings of the Appellant actually working in China. Liability does not attach to earnings of the Appellant whilst working outside China. The figure of \$690,040 was used as part of the formula to arrive at the former. It does not mean that the entirety of that sum was chargeable to income tax in China.

11. We are satisfied that the Revenue is correct in assessing the Appellant on the basis that only \$520,934 is within the exclusion under section 8(1A)(c). The Revenue had paid due regard to the 'Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the avoidance of double taxation of income'. We dismiss the appellant's appeal and confirm the assessment.

Schedule I

Month	Wages in China (in HK\$)	Wages outside China (in HK\$)	Total earnings (in HK\$)	Applicable exchange rate	Total earnings (in RMB)	Deduction (in RMB)	Total income (in RMB)	Tax rate	Fast calculation amount (in RMB)	Assessable income per month (in RMB)	No of days outside China	No of days in that month	Tax assessed in China (in RMB)
April 1998	20,000	35,120	55,120	1.0683	58,884.70	4,000	54,884.70	30%	3,375	13,090.41	13	30	9,476.14
May 1998	20,000	35,120	55,120	1.0692	58,934.30	4,000	54,934.30	30%	3,375	13,105.29	15	31	9,064.92
June 1998	20,000	37,980	57,980	1.0689	61,974.82	4,000	57,974.82	30%	3,375	14,017.45	10	30	10,956.72
July 1998	20,000	37,980	57,980	1.0681	61,928.44	4,000	57,928.44	30%	3,375	14,003.53	16	31	9,269.05
August 1998	20,000	37,980	57,980	1.0692	61,992.22	4,000	57,992.22	30%	3,375	14,022.66	17	31	8,985.40
Sept 1998	20,000	37,980	57,980	1.0673	61,882.05	4,000	57,882.05	30%	3,375	13,989.62	19	30	8,185.78
Oct 1998	20,000	37,980	57,980	1.0673	61,882.05	4,000	57,882.05	30%	3,375	13,989.62	17	31	8,964.23
Nov 1998	20,000	37,980	57,980	1.0683	61,940.03	4,000	57,940.03	30%	3,375	14,007.01	27	30	5,749.20
Dec 1998	20,000	37,980	57,980	1.0678	61,911.04	4,000	57,911.04	30%	3,375	13,998.31	20	31	8,082.41
Jan 1999	20,000	37,980	57,980	1.0676	61,899.45	4,000	57,899.45	30%	3,375	13,994.83	16	31	9,263.29
Feb 1999	20,000	37,980	57,980	1.0693	61,998.01	4,000	57,998.01	30%	3,375	14,024.40	18	28	8,118.65
March 1999	20,000	37,980	57,980	1.0685	61,951.63	4,000	57,951.63	30%	3,375	14,010.49	13	31	10,161.81
	240,000	450,040	690,040		737,178.75		689,178.75			166,253.63	201	365	106,277.60