INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D19/89

Salaries tax– whether employment inside or outside Hong Kong – CIR v Goepfert applied.

Taxpayer in person – procedure for taxpayer to give evidence.

Panel: William Turnbull (chairman), Donald Cheung Quintin and E M I Packwood.

Date of hearing: 15 March 1989.
Date of decision: 23 June 1989.

The taxpayer was employed by a company in China to perform duties in Hong Kong and China. He was at the same time employed by a company in Hong Kong but was not required to perform any services nor did he receive any remuneration from the company in Hong Kong. It was argued on behalf of the Commissioner that the taxpayer was employed in Hong Kong to perform services in Hong Kong and China.

Held:

The taxpayer was employed by a company in China and that his employment was outside of Hong Kong. Accordingly he was entitled to the benefit of the 'days in – days out' principle under which only that part of his income which relates to services rendered in Hong Kong is taxable.

The taxpayer appeared in person and with the consent of the representative for the Commissioner a procedure was established for the giving of evidence in chief by the taxpayer.

Cases referred to:

CIR v George Andrew Goepfert 2 HKTC 210
D37/88, IRBRD, vol 3, 360
BR 20/69, IRBRD, vol 1, 3

Leung Yiu Hong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

This is an appeal by a Taxpayer against a salaries tax assessment for the year of assessment 1985/86. The Taxpayer claims that during the year in question he was employed by a company in China and should not be subject to salaries tax in Hong Kong. Tax has been assessed on the basis that the Taxpayer was employed by a company in Hong Kong to perform duties for it in China but spent part of his time performing duties in Hong Kong.

As this appeal depends entirely upon the view which the Board takes of the evidence and facts we will first summarize the facts which are not in dispute and then analyse in greater detail the evidence and the facts which are in dispute.

The facts not in dispute are as follows:

1. The Taxpayer was employed by a Hong Kong company ('the Hong Kong company') under terms and conditions set out in a letter dated 14 September 1984. This letter stated, inter alia, that the Taxpayer would be required to work full time in Shenzhen. It further stated that his hours of work would be Monday to Saturday from 9:00 am to 6:00 pm with every alternative Saturday off. His annual leave entitlement was two weeks comprising eleven working days. The letter made no reference to the Taxpayer being seconded to work for any other company.

2. In respect of the period from 1 October 1984, the date of commencement of employment, up to 31 March 1985, the Taxpayer filed his tax return in which he declared the income which he received from the Hong Kong company. This was duly assessed to tax. The Hong Kong company filed an employer's tax return in respect of the Taxpayer and stated that it had paid the amount declared by the Taxpayer as his salary/wages.

3. In respect of the year of assessment 1984/85 the Taxpayer agrees that he was employed by the Hong Kong company and that, notwithstanding the contract of employment which stated that he would be required to work full time in Shenzhen, his income arose in and was derived from Hong Kong.

The subsequent facts are in dispute. The Commissioner maintains that in respect of the period subsequent to 31 March 1985 the Taxpayer continued to be employed as previously and that accordingly his salary continued to arise in and to be derived from Hong Kong.

In his submission to us the representative for the Commissioner pointed out that the onus of proof is upon the Taxpayer to satisfy the Board that the assessment appealed against is excessive or incorrect. He drew our attention to the provisions of section 8 of the Inland Revenue Ordinance relating to salaries tax and in particular sub-sections 1A and 1B. In summary he drew our attention to the provisions which require a person to pay tax on all income derived from services rendered in Hong Kong and to the exclusion of income

derived from services rendered outside of Hong Kong and what has become commonly called 'the 60 days rule'.

The Commissioner's representative cited the High Court decision of CIR v George Andrew Goepfert 2 HKTC 210 and pointed out that it is binding on this Board. He also drew our attention to Board of Review case D37/88 which he said is the only Board of Review decision since the Goepfert case.

On the strength of the authorities which he had cited, the Commissioner's representative submitted that the factors to be looked at by the Board are:

(a) whether the employer in question was resident outside Hong Kong;

(b) whether the relevant contract of employment was negotiated, entered into, and enforceable outside Hong Kong; and

(c) whether the income in question was paid to the Taxpayer outside Hong Kong.

Based on the three factors which he had submitted the representative then analysed the facts and submitted that throughout the year in question the Taxpayer had continued to be employed by the Hong Kong company and though he performed part of his services in Shenzhen he also performed services in Hong Kong and spent considerably more than 60 days of the year in Hong Kong.

The Taxpayer appeared in person and represented himself. He elected to give evidence and to be cross-examined. We found the Taxpayer to be frank and honest and accept the evidence which he gave.

Before analysing the evidence and finding the facts we would like to refer to a procedural point which was handled to the satisfaction of the Taxpayer and the Commissioner's representative and which is a point which has arisen previously in cases of this nature. Where a Taxpayer appears and represents himself and has no legal training or knowledge, it is difficult for him to make his submission to the Board and then repeat what he may have said in evidence. In the present appeal it was clear that the outcome of the case would depend entirely upon the evidence and facts. The procedure adopted with the consent of the Commissioner's representative was for the Chairman of the Board to ask the Taxpayer non-leading questions of a general nature which were invitations to the Taxpayer to state the facts which he wished to bring to the attention of the Board. The Commissioner's representative was invited to take objection to any question which the Chairman might put in the same way as he would if the question had been put by a tax representative of the Taxpayer.

The foregoing procedure worked smoothly and to the satisfaction of both parties. It avoided the problem which has so frequently happened in the past when the Taxpayer, in giving evidence, has repeated submissions and arguments rather than giving

evidence on factual matters. It also enabled evidence to be given on the matters which were in dispute with clarity so that the Commissioner's representative was in the position of being able to cross-examine the Taxpayer in the same way as he would have been able to do if the Taxpayer had been represented.

In putting questions to the Taxpayer the Chairman and other members of the Board were careful to avoid 'descending into the arena'. No attempt was made to assist the Taxpayer in presenting his case or his evidence other than drawing to his attention, in question form the areas of fact which were in dispute between the Taxpayer and the Commissioner and were material to the appeal.

The evidence of the Taxpayer was to the effect that when he was first employed by the Hong Kong company he was told that he would be working for another company in China. During the period up to 31 March 1985 the Taxpayer was employed by the Hong Kong company and remunerated by the Hong Kong company and accordingly declared his income as taxable in Hong Kong. The Taxpayer said that with effect from 1 April 1985 he was employed by a company in China which was incorporated in and carrying on business in China ('the Chinese company'). He said that he was seconded full time to work for the Chinese company. He said that he was required to work in an office in China and that the Chinese office was controlled by a local person in China. He said that his job was to be an architectural consultant for a number of development projects which were taking place in China, namely developing old buildings in Shenzhen and building offices, a shopping mall and a small hotel.

The Taxpayer produced a copy of a certificate issued by the Chinese company which stated that the Taxpayer was a member of the staff of the Chinese company and that he was paid by the Chinese company and set out a description of his job. As this certificate is of considerable importance we set out the wording (translated into English) as follows:

24 March 1987

Certificate

Mr X was employed by (the Hong Kong company) to work as our company's designer. From October 1984, he has been a staff of (the Chinese company), his salary is remitted by (the Chinese company) to (the Hong Kong company) for payment to (the Taxpayer).

His position is architectural engineering and interior design consultant, responsible for providing architectural-design technology, facilities, information and so on.

(The Taxpayer) does not have to station in the company all the time.

Chop of

(the Chinese company)

The Taxpayer also produced, a number of certificates of payment of individual income tax certifying that he had paid tax to the government in China on the salary which had been paid to him by the Chinese company. He further produced an employer's tax return issued by the Hong Kong company for the year 1985/86 which was very significantly different from that filed by the Hong Kong company for the preceding year. The employer's tax return for 1985/86 prepared by the Hong Kong company stated that the Hong Kong company did not pay any remuneration to the Taxpayer but that remuneration was paid to him by the Chinese company.

The Commissioner's representative cross-examined the Taxpayer. We would like to express our appreciation of the manner in which the Commissioner's representative cross-examined the Taxpayer and handled the case on behalf of the Commissioner. It was apparent that he wished to ascertain the facts for the benefit of both parties and not to try and establish the Commissioner's case in an adversarial manner in opposition to the Taxpayer's case. The approach by the Commissioner's representative was of considerable assistance to the Board in reaching its decision and is to be commended.

The Commissioner's representative put to the Taxpayer the Commissioner's case which was that the Hong Kong company had continued to employ the Taxpayer throughout 1985/86 as it had in the preceding year, that there was no employment contract between the Chinese company and the Taxpayer and that the Taxpayer was paid by the Hong Kong company with the Hong Kong company being reimbursed by the Chinese company without any change of employment status. With due respect to the Commissioner's case it was clear from the evidence of the Taxpayer that this was not the situation. It was clear that the Taxpayer was paid by the Chinese company. The Hong Kong company physically made salary payments in Hong Kong because it was not possible for the Chinese company to make payments in Hong Kong dollars, which was the remuneration base of the Taxpayer in China. Because of this the Chinese company arranged for the Taxpayer to be paid by the Hong Kong company as the agent for and on behalf of the Chinese company. This was in accordance with the employer's return filed by the Hong Kong company, in accordance with the certificate of employment issued by the Chinese company and in accordance with the fact that the salary was taxed in China.

One of the important documents produced to us was a letter dated 1 December 1988 from the Hong Kong company to the Taxpayer informing the Taxpayer that the management of the Chinese company had decided to grant him an increase of salary. Though this letter was in respect of a period subsequent to the year in question it was common ground between the Taxpayer and the Commissioner's representative that the employment of the Taxpayer continued subsequent to 1985/86 as it had during that year. The letter dated 1 December 1988 read as follows:

Salary Review

We are pleased to inform you that the management of (the Chinese company) have recently decided to grant you an increment of salary of $3,150 per month. This increment is to be retrospective from 1 April 1988. Your salary effective from the date will therefore be $12,500 per month.

A cheque amounting to $25,200 covering the increments is enclosed.

This letter makes it clear that decisions with regard to the Taxpayer's remuneration were made by the Chinese company. The Hong Kong company was doing no more than notifying the Taxpayer of a decision which had been taken by the Chinese company.

Having carefully reviewed the evidence of the Taxpayer and all of the documents before us we find the following additional facts:

1. During the year of assessment 1985/86 the Taxpayer was employed and remunerated by the Chinese company for services which the Taxpayer was performing for the Chinese company. Throughout the year 1985/86 the Taxpayer was in the full time employment of the Chinese company.

2. The employment by the Hong Kong company of the Taxpayer was not terminated but continued on the de facto terms that the Taxpayer was seconded at no salary to work full time for, be employed by, and be paid by, the Chinese company.

3. During the year 1985/86, though working full time for the Chinese company, the Taxpayer only visited China on 16 occasions and was absent from Hong Kong for less than 32 days. On the evidence before us we are not able to state the precise number of days that the Taxpayer spent in China.

4. Throughout the year 1985/86 the Taxpayer was in the full time employment and performing services for the Chinese company. When giving evidence he stated that he only had holidays in accordance with usual practice and procedure that is Sundays, public holidays, annual leave, etc, and accordingly we find as a fact that he was performing duties throughout the year for the Chinese company including the extensive periods of time which he spent in Hong Kong.

5. Throughout the year 1985/86 the Taxpayer was resident in Hong Kong.

Having ascertained these additional facts as we have, it is apparent that the Taxpayer throughout the period had two employers namely the Hong Kong company and the Chinese company. As he performed no services for and received no remuneration from the Hong Kong company his employment by the Hong Kong company can be disregarded for tax purposes. With regard to the Chinese company he was employed by the Chinese

company to perform services in China and Hong Kong. Section 8(1A) of the Inland Revenue Ordinance provides that any person who performs services in Hong Kong is subject to tax on the remuneration which he receives for those services. We understand that the practice and the procedure of the Inland Revenue Department is to assess tax on the 'days in/days out' rule and in the present case we decide that this is the appropriate method for assessment of the Taxpayer for the year of assessment 1985/86.

In reaching our decision we have taken careful note of the Goepfert case which is binding on us. In the Goepfert case, Macdougall J points out (at pages 236/7) that the place where the services are rendered is not relevant in ascertaining the source of income. Regard must be had to the contract of employment. He says at page 237:

> ' 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. It occurs to me that sometimes when reference is made to the so called 'totality of facts' test it may be that what is meant is this very process. If that is what it means then it is not an enquiry of a nature different from that to which the English cases refer, but is descriptive of the process adopted to ascertain the true answer to the question that arises under section 8(1).
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> It is plain that, without specifically referring to the English cases, the Board of Review in BR 20/69 applied the correct test in dismissing the appeal of an appellant taxpayer. Had the converse factual situation existed, that is to say, had the taxpayer been employed by an overseas company who paid for the services rendered by the taxpayer in Hong Kong from money originating overseas, the Board, in applying the reasoning they employed in that case, would have been obliged to decide that the taxpayer's income was not liable to salaries tax under section 8(1). It is not surprising therefore that section 8(1A)(a) was enacted so as to operate as an extension to the basic charge under section 8(1).'

What we must do is to decide where was the Taxpayer's employment. This we find to be outside of Hong Kong. The employer was outside of Hong Kong with no operations in Hong Kong and it employed the Taxpayer to work full time for it in, or out of, its office in Shenzhen. The Taxpayer was employed by the Chinese company to assist it in carrying on its development projects, all of which were in China. The fact that the Taxpayer was recruited overseas and paid in a foreign currency overseas is not sufficient to take his employment outside of China. Indeed his salary, though physically paid in Hong Kong was paid out of moneys which originated in China. (It is immaterial whether the moneys were remitted by the Chinese company to its agent in Hong Kong in advance or in arrear.)

Having so decided we direct the assessment appealed against be referred back to the Commissioner so that the amount of the assessment can be reduced and the Taxpayer can be re-assessed on the basis which we have stated. In the additional facts set out above

we have not been able to find the exact number of days which the Taxpayer spent in China and the number of days which the Taxpayer spent in Hong Kong. The Taxpayer was physically present in China on all or part of a total of 32 days during 16 visits. However as we have found that the source of the Taxpayer's employment was China it is necessary to ascertain the days spent in Hong Kong. We leave it for the Commissioner to agree the number of days with the Taxpayer. In the event of the Commissioner and the Taxpayer not being able to agree the number of days which the Taxpayer spent in Hong Kong we direct that either party shall be at liberty to apply to this Board to determine the matter after additional evidence has been called.