INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D24/93

Salaries tax – whether taxpayer an employee or independent agent – broker's runner.

Panel: Howard F G Hobson (chairman), Audrey Eu Yuet Mee QC and Ronald Leung Ding Bong.

Dates of hearing: 21 & 22 June 1993.
Date of decision: 3 September 1993.

The taxpayer was employed under a contract to perform services as a runner for a broker. The question for the Board to decide was whether the taxpayer was an employee under a contract of service or was an independent contractor.

Held:

On the facts before it the taxpayer was an employee and not an independent contractor.

Appeal dismissed.

Cases referred to:

D54/90, IRBRD, vol 5, 414
D77/90, IRBRD, vol 5, 525
Market Investigations Ltd v Minister of Social Securities [1969] 2 QB 173
D19/78, IRBRD, vol 1, 323
D67/87, IRBRD, vol 3, 97
Lee Tin Sang v Chung Chi Keung and Another [1990] 2 WLR 1773
Spratt v Inland Revenue Commissioner (NZ) [1964] 9 AITR 277
Hadlee and Another v Commissioner of Inland Revenue [1993] STC 294
Ferguson v John Dawson & Partners (Contractors) Ltd [1976] 3 ALL ER 817

Mei Yin for the Commissioner of Inland Revenue.
Norman L K Lee of Lee, Au & Co for the taxpayer.

Decision:

This appeal is concerned with whether during the 1990/91 year of assessment the Taxpayer was employed under a contract of service (that is as an employee) or whether A Ltd, a company owned by the Taxpayer and members of his family, was engaged under a contract for services (that is as an independent contractor).

BACKGROUND

The following facts are not in dispute.

1. By an agreement headed 'AE/RUNNER', dated 1 May 1989 and made between (1) B Ltd, therein referred to as 'the Dealer'; (2) C Ltd, therein referred to as 'the Financier'; and (3) the Taxpayer, therein referred to as 'AE/RUNNER'. The agreement, obviously B Ltd's own standard precedent, contains space to insert the name of a guarantor but no name appears.

The following verbatim extracts are relevant:

Quote

(A) The AE/Runner has agreed to introduce from time to time to the Dealer securities trading customers acceptable to the Dealer ('AE/Runner Customers').

(B) Some or all the AE/Runner Customers are expected to open accounts with the Financier for the purpose of financing their securities trading on accounts with the Dealer.

(C) The Dealer, the Financier and the AE/Runner have agreed to regulate the arrangements between them, and the Guarantor(s) has/have agreed to guarantee the AE/Runner's performance, in each case as provided in this agreement.

1. AE/Runner's Functions

1.01 The AE/Runner shall act (and be registered under the Securities Ordinance) as a dealer's representative for the Dealer. In so acting, the Runner shall not be either a partner or an agent of the Dealer and shall accordingly have no authority to, and shall refrain from, seeking to impose on the Dealer any obligation or liability to any AE/Runner Customers or any other person, and shall indemnify the Dealer against all claims made by any AE/Runner Customer or other person or other loss or expense suffered by Dealer in connection with any breach by the AE/Runner of this clause 1.01.

1.02 The AE/Runner shall act as the agent of each AE/Runner Customer and, prior to delivering to the Dealer any instructions on behalf of any AE/Runner Customer, shall ensure that such AE/Runner Customer signs and delivers to the

Dealer such agreement(s) and documentation as the Dealer shall require, including (but not limited to) written confirmation by such AE/Runner Customer of the AE/Runner's authority to give instructions and receipts to the Dealer on behalf of such AE/Runner Customer.

1.03 The AE/Runner's functions are to act on behalf of each AE/Runner Customer in respect of such AE/Runner Customer's sale and purchase of Futures Contracts ('Futures Contracts') and to place with the Dealer buying and/or selling orders and give all other instructions and/or receipts on such AE/Runner Customer's behalf, provided always that the Dealer shall not be obliged to accept such buying and/or selling orders and/or other instructions and/or receipts and the Dealer shall be at liberty to reject any such orders, instructions or receipts as when the Dealer thinks fit without assigning any reason therefor. Such right to reject orders, instructions and receipts given by the AE/Runner on any AE/Runner Customer's behalf and the status of the AE/Runner as agent of each AE/Runner Customer and not of the Dealer shall not be affected by the Dealer authorising the AE/Runner in individual cases outside the terms of this agreement to act on behalf of the Dealer solely for the purpose of accepting and processing orders, instructions or receipts.

2. Commissions

Commissions received from AE/Runner Customers for the sale and purchase of Securities by the Dealer on such AE/Runner Customers' behalves are to be shared between the AE/Runner and the Dealer in such proportions as the AE/Runner and the Dealer shall from time to time agree.

3. Guarantee and Indemnity by AE/Runner

3.01 The AE/Runner shall be fully responsible for and hereby unconditionally and (subject to clause 3.03) irrevocably guarantees the due performance by each AE/Runner Customer of all his obligations of any nature whatsoever to the Dealer and/or the Financier, whether in connection with facilities made available by the Dealer and/or the Financier for securities trading and/or margin financing thereof or in connection with any other matter whatsoever.

3.02 Without prejudice to the generality of clause 3.01 hereof, if and whenever any AE/Runner Customer shall make default in the payment of any amount payable by him to the Dealer and/or the Financier, the AE/Runner shall forthwith upon demand by the Dealer and/or the Financier unconditionally pay to the Dealer the amount in respect of which such default has been made and, if and whenever any AE/Runner Customer shall in any respect commit any breach of any of his obligations to the Dealer and/or the Financier (including, without limitation, any failure to pay for or collect securities purchased, to transfer and/or deliver securities sold or the certificates therefor or to pay or repay amounts owning on any margin financing account or upon any margin call), the

AE/Runner shall indemnify each of the Dealer and the Financier against all losses, costs, claims, demands, expenses and liabilities (including, without limitation, consequential loss and loss of profit) which may be incurred by such party hereto by reason of or in connection with any such breach.

3.05 Without prejudice to the rights of the Dealer and/or the Financier against each AE/Runner Customer as principal obligor, the AE/Runner shall, as between the Dealer and/or the Financier on the one hand and the AE/Runner on the other hand, be deemed a principal obligor in respect of his obligations under this clause 3 and not merely a surety and accordingly the AE/Runner shall not be discharged nor shall his liability be affected by any act, thing, omission or means whatsoever whereby his liability would not have been discharged if he had been a principal obligor.

4. Delivery of Securities by AE/Runner

Without prejudice to his obligations under clause 3 hereof, the AE/Runner shall be fully responsible for the authenticity of all share certificates or other certificates of title delivered to the Dealer either by the AE/Runner or by AE/Runner Customers themselves. If for any reason any of such certificates are not accepted by the Dealer, by other registered securities dealers or by other person, firms or companies concerned, the AE/Runner shall acquire at his own cost and expense the same amount of securities and deliver acceptable share certificates or other certificates of title to the Dealer immediately upon demand and the AE/Runner shall indemnify each of the Dealer and the Financier against all loss and any claim by any party against the Dealer and/or the Financier arising directly or indirectly in connection therewith.

5. No Employment (For Runner Only)

The Runner shall not be an employee of the Dealer or the Financier and the Employee's Compensation Ordinance and the Employment Ordinance shall not apply to this agreement.

Unquote

The agreement does not contain any specific commencement date but apparently it took effect from 1 May 1989.

It is common ground that prior to 1 March 1990 the title 'Account Executive' and its acronym 'AE' was used with respect to those persons who work for B Ltd as employees, whereas 'Runner' was the term used for those who work for B Ltd as independent contractors. With this in mind the agreement itself is ambiguous because in completing the proforma, no attempt was made to establish whether the role of the Taxpayer was to be that of an Account

Executive or a Runner, by deleting 'AE' or 'Runner' wherever they appeared or to deleting or positively affirming the aptness of clause 7.

5.1 The agreement contains no reference to A Ltd. However at the outset the Taxpayer requested B Ltd to pay to A Ltd the remuneration which was due to him pursuant to the agreement. B Ltd acceded to that request. By a document headed 'Letter of Authorization' and dated 1 May 1989 (which was adjudicated for stamp purposes on 11 May 1989 presumably to preserve its authenticity) the board of A Ltd authorized 'the Taxpayer to represent the company to act as commission runner for B Ltd and account for all commission income to A Ltd with effect from May 1989'.

5.2 In response to enquiries, B Ltd sent the assessor a copy of a hand written letter by the Taxpayer dated 4 October 1991 to the effect that as B Ltd were unable to find the previous authorization letter, the Taxpayer confirmed his 'authorization to you to credit all remuneration due to the account of A Ltd'.

5.3 B Ltd filed an employer's return dated 30 April 1991 for the year ended 31 March 1991 with respect to Taxpayer, showing the income accruing to the Taxpayer during the basis year as $12,000 in salary and $132,017 in commission, making a total of $144,017.

5.4 Nonetheless A Ltd filed an employer's return also dated 30 April 1991 also for the Taxpayer for the same period showing salary of $60,000 accruing to the Taxpayer from A Ltd.

5.5 A 1990/91 salaries tax assessment was raised on the Taxpayer based upon the B Ltd employer's return at 3.1 above. The Taxpayer objected contending that he was not an employee of B Ltd. The Deputy Commissioner upheld the assessment.

5.6 A Ltd filed a profits tax return, for the same period as the salaries tax assessment under appeal, which includes the $144,017 referred to at 3.1 above.

GROUNDS OF APPEAL

The grounds of appeal put forward by the Taxpayer's tax representative may reasonably be summarized as follows:

1. The contract with B Ltd was a contract for service(s) and not a contract of service. Hence the income in question should not be liable to salaries tax.

2. Owing to the nature of work (Commission Runner), the work had to be performed personally by the Taxpayer. It cannot be performed by a company which is not a natural person.

3. Although the contract with B Ltd was signed by the Taxpayer, he was signing for an on behalf of A Ltd as the latter company (A Ltd) authorized the Taxpayer to represent it to act as Commission Runner for B Ltd.

4. The Taxpayer at all times was acting for an on behalf of A Ltd in relation to the contract with B Ltd.

5. The commission income derived from B Ltd belonged to A Ltd per the Letter of Authorization and the income was in fact turned over to A Ltd accordingly, (thereby becoming assessable to profits tax in the hands of A Ltd).

6. The Taxpayer derived salaried income from A Ltd for services rendered including services rendered to B Ltd (becoming assessable income of the Taxpayer under salaries tax).

7. Since the commission income has been fully assessed to A Ltd under profits tax, the same piece of income should not be assessed to the Taxpayer for the second time under salaries tax. The Deputy Commissioner's representative advised the Board that if the appeal failed then A Ltd's profits tax assessment would be revised to exclude the $144,017 and an appropriate refund of tax would be made.

8. For the sake of argument and without prejudice, even if the commission income is regarded as accruing to the Taxpayer in the first place liable to profits tax, it would be legitimate for the Taxpayer to claim that under the Letter of Authorization, such income has to be turned over to A Ltd so that he himself would have no assessable income under profits tax.

TESTIMONY

The Taxpayer gave his evidence in a frank manner. He told that in May 1989 B Ltd made a clear distinction between 'staff', which is to say Account Executives, and Runners who are not part of the staff. He was given the choice of categories. Account Executives at that time got $8,000 per month, plus commission but only when the monthly turnover exceeded $10,000,000. A Runner's remuneration on the other hand was confined to a share of the commission charged to the customer. Prior to 1 March 1990, the 0.5% commission charged to customers was split 0.35 to the Runner and 0.15 to B Ltd. He decided to be Runner.

Early in 1990 the Management of B Ltd wanted to increase its share of the commission to 0.175 and therefore in exchange for their reduced share Runners were to be given $1,000 per month salary commencing 1 March 1990, and would be covered for medical expenses. There was no opportunity to negotiate these terms – they were presented as a fait accompli. It was his understanding that after 1 March 1990 all titles were changed to Account Executives but the Taxpayer maintained that such name change had no effect on his original self-employed status.

As a Runner, the Taxpayer was not required to work normal office hours or to work on Saturdays; Runners left the office when they finished their work. Account Executives however worked till 5:30 pm and on Saturday mornings.

During cross examination it became clear that he was not familiar with the Securities Ordinance, chapter 333, but recalled that B Ltd sponsored his application for a 'dealer's representative' license. He recognized that those passages in the May 1989 agreement denying the AE/Runner's status as agent of the dealer were inconsistent with the statutory definition of a 'dealer's representative'. It was the Taxpayer's belief that his customers perceived him as either an agent or an employee of B Ltd.

The Taxpayer's attention was drawn to a letter of 4 June 1993 by B Ltd to the Commissioner of Inland Revenue in which it is stated that the Taxpayer 'held the same position – Account Executive in the period that you mentioned (1 May 1989 – 31 March 1991)'. The Taxpayer said that information was wrong. He acknowledged that he was entitled to take twelve days' paid leave each year – though in fact he had not taken any – and that he was covered by B Ltd's medical insurance scheme. He was unsure how he stood with regard to Workmen's Compensation as he had never given the matter any thought: the 4 June letter said the Taxpayer 'is under the coverage of Workmen's Compensation'.

On being asked who would take action if a customer defaulted (for example as where a customer's cheque for a non-margin, cash deal, bounces) the Taxpayer replied that B Ltd would take action against the customer and himself.

The Taxpayer told us that his customers would not know of A Ltd. A Ltd's shareholders are himself, his father, his mother and his mother-in-law. The last three refer business to the Taxpayer. On being asked why A Ltd did not obtain a dealer's representative's license, the Taxpayer gave us to understand that since B Ltd sponsored the Taxpayer's own application for a license it was unlikely that they would sponsor A Ltd. Moreover, he felt that B Ltd would also want to be able to sue him personally in case of need.

The Taxpayer produced four name cards which B Ltd had had printed for him. The earliest in time referred to him as 'Marketing' but the Taxpayer said that was equivalent to a Runner. Two other cards showed him as an Account Executive and the fourth and most recent card referred to him as an Investment Consultant: no explanation had been given to him for this later change of title.

At the Board's request Miss A, the Personnel Manager of B Ltd who had signed the employer's return and certain correspondence with the IRD including the 4 June letter, gave evidence on oath. In regard to that letter she confirmed the accuracy of the statement to the effect that the Taxpayer was an Account Executive. However she said that the Taxpayer had been an employee only since March 1990, before that he was regarded by B Ltd as an independent Runner because he only received commission. On the matter of workmen's compensation, she said the Taxpayer numbered amongst those covered

although in common with others, he was not specifically named. She said that the Taxpayer in common with others commissioned Account Executives was only required to attend at the office during normal stock exchange hours. She confirmed that B Ltd still engaged independent Runners and that the latter only got commission and did not get other benefits, that is vacations with pay, and medical cover – these people did not have to attend the office if they did not want to. B Ltd has a provident scheme but those employees who received commission were not eligible. Miss A told us that B Ltd kept a list of Runners and of Account Executives and that the Taxpayer appeared in the Account Executives' List.

SUBMISSIONS

The Taxpayer's representative referred us to the Board of Review Decisions, D54/90, IRBRD, vol 5, 414 and D77/90, IRBRD, vol 5, 525. Both these involved persons working for stock or commodity broking firms under written contracts. In D54/90 the written contract expressly stated that it would under no circumstances be construed as creating between the parties the relationship of employer and employee. Nonetheless the broking firm filed an employer's tax return. The following factors (amongst others) were felt to be consistent with a contract for services:

(a) The taxpayer purchased his own pager and mobile phone. In D77/90 the broking firm provided these but the taxpayer paid for the calls. In the instant case no evidence was forthcoming on this aspect.

(b) The taxpayer in D54/90 hired his own helpers. In D77/90 the taxpayer did not have helpers but he had the right to appoint sub-agents. In this case, the Taxpayer's relatives were not paid by him, presumably they expected to be rewarded through their interests in A Ltd.

(c) The taxpayers were not entitled to any employment benefits such as leave entitlement and medical benefits. In this case, after March 1990 the Taxpayer was entitled to both these.

(d) The taxpayers faced financial risks if their customers defaulted. In our case the risk, according to the engagement contract, is the same whether the Taxpayer is self-employed or an employee.

(e) In D77/90 the taxpayer registered himself under the Business Registration Ordinance as self-employed. In this case, the Taxpayer was not registered under the BRO instead the Taxpayer contends that the remuneration did not belong to him in any capacity, rather it belonged to A Ltd.

Apart from the employer's returns and written replies to the assessors, no evidence was given by the employer/principal in the two cited cases. Nor was there any revision of the terms of engagement of the sort that occurred on 1 March 1990.

Close though the facts of the present case are to those in the cited cases we consider that the differences are too significant to treat the decisions as applicable to the appeal before us. The representative for the Deputy Commissioner led us through the various tests which have been adopted over the years by the courts to differentiate between contracts of service and contracts for services, namely the control test, the integration test and the economic reality test. She also referred to the following cases:

Market Investigations Ltd v Minister of Social Securities [1969] 2 QB 173
D19/78, IRBRD, vol 1, 323
D67/87, IRBRD, vol 3, 97
LEE Tin-sang v CHUNG Chi-keung and Another [1990] 2 WLR 1773
Spratt v Inland Revenue Commissioner (NZ) [1964] 9 AITR 277
Hadlee and Another v Commissioner of Inland Revenue [1993] STC 294
Ferguson v John Dawson & Partners (Contractors) Ltd [1976] 3 All ER 817

In our view, the control test has no relevance to the present case since the function of a dealer's representative (to adopt a neutral term) is to relay a customer's order to B Ltd's dealing room for processing. The decision-making lies with the customer. The manner of processing an order and degree of control by the representative would, we apprehend, be the same whether he was an employee or an independent. The integration test is relevant since apart from having no participation in B Ltd's provident scheme, Miss A's testimony strongly indicated that during the relevant period the Taxpayer was 'part and parcel of the organisation' (per Denning LJ referred to in Market Investigation case). The economic reality test looks at the other side of the coin by noting certain criteria associated with a person who is in business on his own account, such as (a) providing his own equipment, (b) hiring his own helpers, (c) assuming a degree of financial risk; (d) undertaking a degree of responsibility for investment and management and (e) the opportunity of profiting from sound management in the performance of his duties. There was no evidence given regarding provision of equipment but it was the Taxpayer's position that his family helped him but as no evidence was given concerning any salary or commission he paid to them, we assume they expected to be rewarded through their shareholding in A Ltd. As to criterion (c), it seems to us that the wording in the May 1989 agreement is such that the financial risk is intended to be the same for an Account Executive as it is for a Runner. Likewise, we see little to differentiate between a Runner or Account Executive so far as criteria (d) & (e) are concerned. In Hong Kong we think that registration under the Business Registration Ordinance is another criterion which could weigh in favour of the inference of independent contractor. The Taxpayer was evidently not so registered.

CONCLUSION

We heard no evidence to suggest that the type of work differed according to whether the person carrying out the work was a Runner or an Account Executive, nor to suggest that the manner in which it was carried out or controlled differed in any way. Indeed, the proforma agreement at least as adopted in the present case treats that the duties, responsibilities and even the indemnities as identical for both types of engagement.

The terms of the 1989 agreement have tended to confuse the relationship of the parties. In so far as an Account Executive employee is concerned the agreement states in clause 1.02 that the employee acts as agent for customers. This suggests that if the employee gets the order wrong the customer cannot look to B Ltd for recompense. Not only is this a strange anomaly but it appears to be inconsistent with the Securities Ordinance which defines a dealer's representative as a person in the employment of or acting for or by arrangement with a dealer. In view of the latter we consider that those provisions which are inconsistent should be ignored. However having reached that conclusion none of the spurious terms really affects the question of whether the Taxpayer was an employee during the relevant period.

Despite the Taxpayer's stated belief that during the relevant period he was an independent contractor, he acknowledged that he was entitled to medical expenses and paid leave. Whilst the provision of these benefits may not be absolutely incompatible with a contract for services we apprehend their inclusion must be extremely rare, especially, as here, where the medical cover is provided through a scheme applicable to all employee as opposed to ad hoc insurance taken out for an independent contractor working on a given project.

We therefore consider that the integration test has been satisfied and accordingly we find that the Taxpayer was an employee during the relevant period.

The matter does not however end there for it will be recalled that the grounds of appeal included the argument that if the Board find (as we have done) that the Taxpayer was an employee, then he was acting in that capacity as agent for A Ltd (an undisclosed principal) and in consequence of the 1 May 1989 Letter of Authorization all income received should be turned over to A Ltd, consequently the Taxpayer had no taxable salary. In fact the letter refers only to 'commission' – there is no reference to salary because the Taxpayer received no salary until March 1990. In our view, this argument also fails. The evidence shows quite clearly that B Ltd never regarded the Taxpayer as an agent for A Ltd as a disclosed or undisclosed principal. While B Ltd paid the Taxpayer's salary and commission to A Ltd at the direction of the Taxpayer, it never recognized A Ltd as a party entitled to such payment in its own right. Further, section 50(1) of the Securities Ordinance chapter 333 provides that no person shall act as a dealer's representative in Hong Kong unless he is registered as such. Section 50(1A) of the same Ordinance provides that no corporation may be registered as a dealer's representative. Thus, A Ltd cannot, in law, be employed as a dealer's representative. The Taxpayer, on the other hand, was registered as a dealer's representative. For reasons given, the income was clearly the Taxpayer's income and not A Ltd's income. It is well established that a taxpayer cannot escape assessment of tax resulting from his personal services by directing payment of it to a third party (see Hadlee v CIR). While the letter of authorization may or may not be valid as between the Taxpayer and A Ltd, it is ineffective in law to pass the Taxpayer's tax liability to his company.

We therefore find against the Taxpayer on this alternative issue. This appeal is dismissed.