Case No. D30/03

Salaries tax – new or continuous employment – 60-day exemption – sections 8(1), 8(1A), 8(1B) and 11B of the Inland Revenue Ordinance ('IRO').

Panel: Andrew J Halkyard (chairman), Steven Rudolf Sieker and Richard S Simmons.

Date of hearing: 16 April 2003.
Date of decision: 10 June 2003.

A Hong Kong company ('Hong Kong Co') employed the appellant during the period 1 December 1995 to 31 October 1996 ('the 1995 contract'). A related Singaporean company ('Singapore Co') then employed the appellant as 'Commercial Manager of [Singapore Co]' during the period 1 November 1996 to 31 March 1997 ('the Singapore contract'). Concurrently during the period 1 November 1996 to 31 March 1997, the appellant entered into a further contract with Hong Kong Co for the post of 'Commercial Manager of [Singapore Co]' ('the 1996 contract') for which he was paid a further sum ('Sum A') which represented salary and housing allowance. During the year of assessment 1996/97, the appellant spent a total of 142 days in Hong Kong. During part of this year, namely, the period 1 November 1996 to 31 March 1997, the appellant spent a total of 21 days in Hong Kong.

During the course of the hearing before the Board, the appellant agreed that the 1996 contract was located in Hong Kong. It follows that, unless an exemption applied under the IRO, Sum A was liable to salaries tax under section 8(1) as employment income arising in or derived from Hong Kong. The appellant also agreed that during his 21-day presence in Hong Kong during the period 1 November 1996 to 31 March 1997, he performed services in his capacity as 'Commercial Manager of [Singapore Co]'. It follows that the so-called 'no services in Hong Kong' exemption provided by section 8(1A)(b)(ii) did not apply to the appellant, irrespective of whether the 1996 contract was a new employment with Hong Kong Co or simply a continuation of the 1995 contract.

The issue before the Board was whether the 1996 contract represents a new employment. If so, whether the 60-day exemption in section 8(1B) applies.

Held:

1. Looking at the 1996 contract and the Singapore contract together, it is clear that the appellant's remuneration for what was the same position was split between these two contracts – the Board is inclined to favour the appellant's contention that he and Hong Kong Co had rescinded the 1995 contract and substituted a new self-subsisting agreement for a totally different job.

2. Whilst it is a precondition that services are rendered in Hong Kong under the relevant employment for section 8(1B) to operate, it does not necessarily follow that the 60-day test only applies to the period of that employment without considering a person's physical presence and work in Hong Kong for the period 1 April to 31 March, which forms the basis period for any year of assessment. In the Board's view, section 8(1B) provides a statutory relief that exempts a person from salaries tax in circumstances where that person's connection with Hong Kong during the tax year is not significant and can be disregarded for assessment purposes. Section 8(1B) does not refer to 'visits not exceeding a total of 60 days in the basis period for the year of assessment *for each separate employment*'. Rather it refers, without qualification, to 'visits not exceeding a total of 60 days *in the basis period for the year of assessment*' (emphasis added). Since the appellant's physical presence in Hong Kong during his employment with Hong Kong Co throughout the year of assessment 1996/97 exceeded 60 days, and he rendered services during that year in Hong Kong in accordance with the terms of the 1996 contract with Hong Kong Co, the exemption provided by section 8(1B) does not apply. The provision in section 8(1B) does not admit apportioning the 60-day test in any circumstances.

3. Notwithstanding its conclusion, the Board appreciates that section 8(1B) could arguably be interpreted as applicable to the remuneration under the 1996 contract as if the appellant were a new employee who commences work in Hong Kong in the middle of a tax year and works only up to the end of that tax year. The terms of this provision are not a model of clarity and, indeed, another Board in D37/01 has suggested that '*it is perhaps time for the legislature to review this subsection to clarify precisely what is the true intention of this subsection*'.

Appeal dismissed.

Cases referred to:

CIR v Goepfert (1987) 2 HKTC 210
D29/95, IRBRD, vol 10, 247
CIR v So Chak Kwong, Jack (1986) 2 HKTC 174
D143/98, IRBRD, vol 13, 667
D37/01, IRBRD, vol 16, 326

Lai Wing Man for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal against an additional salaries tax assessment raised on the Appellant for the year of assessment 1996/97.

2. The basic facts, which we so find, are set out in the Commissioner's determination dated 23 December 2002. This shows that a Hong Kong company ('Hong Kong Co') employed the Appellant during the period 1 December 1995 to 31 October 1996 ('the 1995 contract'). A related Singaporean company ('Singapore Co') then employed the Appellant as 'Commercial Manager of [Singapore Co]' during the period 1 November 1996 to 31 March 1997 ('the Singapore contract'). Concurrently during the period 1 November 1996 to 31 March 1997, the Appellant entered into a further contract with Hong Kong Co for the post of 'Commercial Manager of [Singapore Co]' ('the 1996 contract') for which he was paid a further sum ('Sum A'). Sum A represented salary and housing allowance of approximately $52,700 per month (plus annual bonus). The Appellant's remuneration from Singapore Co under the Singapore contract represented salary of approximately $22,000 per month (plus one month's wage supplement for the Lunar New Year). During the year of assessment 1996/97 (the basis period for this year being 1 April 1996 to 31 March 1997), the Appellant spent a total of 142 days in Hong Kong. During part of this year, namely, the period 1 November 1996 to 31 March 1997, the Appellant spent a total of 21 days in Hong Kong.

3. During the course of the hearing before the Board, the Appellant agreed the following matters:

(a) The 1996 contract was located in Hong Kong (see CIR v Goepfert (1987) 2 HKTC 210). It follows that, unless an exemption applied under the IRO, Sum A was liable to salaries tax under section 8(1) as employment income arising in or derived from Hong Kong. It is this amount that forms the subject of this appeal. The remuneration paid under the Singapore contract was not offered for assessment in Hong Kong and was not in dispute before us.

(b) During his 21-day presence in Hong Kong during the period 1 November 1996 to 31 March 1997, the Appellant performed services in his capacity as 'Commercial Manager of [Singapore Co]'. For these services, he was, in part, remunerated by Hong Kong Co under the 1996 contract. It follows that the so-called 'no services in Hong Kong' exemption provided by section

8(1A)(b)(ii) did not apply to the Appellant – irrespective of whether the 1996 contract was a new employment with Hong Kong Co or simply a continuation of the 1995 contract.

4. On the basis of the above, the issues before this Board are:

(a) Does the 1996 contract represent a new employment? If so, we must then consider whether the 60-day exemption in section 8(1B) applies to the Appellant; or

(b) Does the 1996 contract simply form part of a continuous employment? If so, the Appellant did not dispute that Sum A is properly liable to salaries tax.

Did the 1996 contract amount to a new employment?

5. The main argument during the hearing centred upon this issue. The Commissioner's representative, Ms Lai Wing-man, argued that although the 1996 contract was a new contract, it did not amount to a new employment. In this regard, Ms Lai referred to matters such as: (1) the terms of the 1996 contract (which the Appellant told us envisaged an ongoing relationship with Hong Kong Co under which he was under 'retainer' by Hong Kong Co to render services on ongoing construction disputes referable to his work under the 1995 contract) evidenced a continuing employment relationship; (2) under the 1996 contract Hong Kong Co paid the Appellant an annual bonus which included service referable to the 1995 contract; (3) the 1995 contract was not formally terminated by either party and there was no break in the Appellant's service with Hong Kong Co; and (4) in its communications with the assessor Hong Kong Co referred to the Appellant's posting to Singapore as a 'transfer' rather than a termination of employment.

6. In response, the Appellant urged us to look at the totality of facts and the substance of his contractual relationship with Hong Kong Co. Amongst other things, the Appellant argued that in October 1996 he negotiated a new contract for a totally separate and distinguishable post in Singapore. The Appellant claimed that there was a complete change in duties and responsibilities during the periods before and after 1 November 1996, noting that Singapore Co's business involved dredging and marine construction as opposed to the structural steelwork business carried on by Hong Kong Co in the Mainland. In conclusion, the Appellant contended that both in fact and substance the 1996 contract abrogated the 1995 contract and amounted to a new employment.

7. In considering this matter, we note that in D29/95, IRBRD, vol 10, 247 at 252 the Board of Review cited the following authority germane to this issue:

> *'Substituted contract. A rescission of the contract will also be implied where the parties have effected such an alteration of its terms as to substitute a new*

> *contract in its place. The question whether a rescission has been effected is frequently one of considerable difficulty, for it is necessary to distinguish a rescission of the contract from a variation which merely qualifies the existing rights and obligations. If a rescission is effected the contract is extinguished; if only a variation, it continues to exist in an altered form. The decision on this point will depend on the intention of the parties to be gathered from an examination of the terms of the subsequent agreement and from all the surrounding circumstances. Rescission will be presumed when the parties enter into a new agreement which is entirely inconsistent with the old, or, if not entirely inconsistent with it, inconsistent with it to an extent that goes to the very root of it. The change must be fundamental and "the question is whether the common intention of the parties was to 'abrogate', 'rescind', 'supersede' or 'extinguish' the old contract by a 'substitution' of a 'completely new' or 'self-subsisting' agreement."'* [quoting Chitty on Contracts, 27th edition, volume 1, paragraph 22-025]

8. Looking at the 1996 contract and the Singapore contract together – as we must, since, apart from the limited 'retainer' component, it is clear that the Appellant's remuneration for what was the same position was split between these two contracts – we are inclined to favour the Appellant's contention that he and Hong Kong Co had rescinded the 1995 contract and substituted a new self-subsisting agreement for a totally different job.

9. We note, however, that D29/95 is authority for the proposition that, for the purposes of considering section 8(1A) and (1B),

> '*if what is relevant is employment [the Board of Review indicated that it accepted this proposition], then it is immaterial whether there is a new employment contract in substitution of the original employment contract, so long as the Taxpayer continues to be employed by the same employer. ...*
>
> *Thus the fact that all the services rendered during [the final seven and a half months of the year of assessment under a secondment] were rendered outside Hong Kong does not assist the Taxpayer as the Taxpayer's employment by Company A [the paymaster at all relevant times] was from 1 April 1992 to 31 March 1993 ... It is common ground that [the first four and a half months of the year of assessment during which the Taxpayer worked in Hong Kong for Company A] exceeded 60 days. By reason of subsection (1B), subsection (1A) does not assist the Taxpayer.'* (at page 251, paragraphs 6.2 and 8)

10. Although we do not dispute the actual decision in D29/95, since it appears that the Board was prepared to accept that the taxpayer in that case did not enter into a new employment (at page 251, paragraph 7), we query whether the passage quoted above can apply in all cases

where there is a change of employment with the same employer and, under the new employment, no services were rendered in Hong Kong. For instance, a taxpayer having a Hong Kong employment may work here during April to June, resign, take a holiday overseas in July, return to Hong Kong in August to look for further employment, approach the former employer and conclude a new contract with that employer for a different post in September, and under that new contract spend the rest of the year working overseas. In such a case, we believe that the income from the new employment would be exempted under section 8(1A)(b)(ii). For this purpose, the taxation result should not depend upon whether the employer remains the same (as was the case in D29/95 and in the example above) or has changed, or whether there is any break in time between the two contracts. For present purposes, however, this matter must remain moot since the Appellant did render services in Hong Kong under the 1996 contract and thus section 8(1A)(b)(ii) cannot apply.

11. In the event, we have decided that we need not make a final determination on whether the 1996 contract represents a new employment. The reason is that, as will be explained below, the answer makes no difference to the final outcome of this appeal since the Appellant cannot take advantage of the 60-day test in section 8(1B).

Is the Appellant's income under the 1996 contract exempted under section 8(1B)?

12. The general charging provision for salaries tax, section 8(1), 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 ...'*

13. Deeming provisions under section 8(1A) then provide:

> *'(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;*
>
> *(b) excludes income derived from services rendered by a person who –*
>
> *(i) ...*

(ii) renders outside Hong Kong all the services in connection with his employment.'

14. Finally, section 8(1B) sets out what is commonly referred to as 'the 60-day test'. It provides:

' (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.'

15. The issue for our decision is whether section 8(1B) applies the 60-day test to the period of each employment, regardless of a person's physical presence and work in Hong Kong during the whole of the year of assessment. Contrary to first impression, we have found the interpretation of this provision to present no small amount of difficulty.

16. We propose to deal with this matter by responding to the Appellant's arguments before us (which he made on the basis that the 1996 contract constituted a new employment).

17. (a) *Argument*. It would be inconsistent to count the 60-day period by reference to the full year of assessment. The Appellant's remuneration under the 1995 contract (for the period 1 April to 31 October 1996) has already been subject to the 60-day test and salaries tax was fully paid thereon.

(b) *Response*. Section 8(1) imposes salaries tax on *any* income from employment derived in Hong Kong during a year of assessment. The Appellant's remuneration under the 1995 contract was assessed accordingly. Although forming the basis of an 'Additional' salaries tax assessment, Sum A earned under the 1996 contract remains part of the Appellant's assessable income for the year of assessment 1996/97. The 60-day test applies equally here as it did to the original assessment. The fact that Sum A was subject to an 'Additional' assessment is irrelevant. The argument – and admittedly this response – however begs the question whether the 60-day test applies independently to the period of each and every employment regardless of a person's physical presence and work in Hong Kong during the whole of the year of assessment. This matter is considered at paragraph 18 below.

18. (a) *Argument*. The 60-day test should apply to the remuneration under the 1996 contract as if the Appellant were a new employee who commences work in Hong Kong in the middle of a tax year and works only up to the end of that tax year.

(b) *Response*. As stated earlier in this decision, it is our view that the 'no services in Hong Kong' exemption provided by section 8(1A)(b)(ii) applies to each separate employment held by the taxpayer. This conclusion is consistent with the structure of the charge to salaries tax provided by section 11B, which states that a person's assessable income in any year of assessment is the aggregate amount of income accruing from all sources in that year.

(c) We note that if 'income … from any employment' in section 8(1A) was referable to employment income generally, and not to each specific source of employment income, then section 8(1A)(b)(ii) could not apply where a local taxpayer holding a Hong Kong employment worked in Hong Kong for say ten days only between 1 April and 10 April, resigned from that employment, and then worked overseas under a new contract of employment with another employer without returning to Hong Kong for the duration of the year of assessment. If the second contract of employment were also a Hong Kong employment, then all the taxpayer's employment income would be subject to salaries tax (and the 60-day test could not assist since the taxpayer rendered services in Hong Kong during a period when the taxpayer was not a visitor). We would suggest that such an interpretation and result could not possibly be correct.

(d) If our analysis is right, it is then clear that the references to 'services' in section 8(1B) must relate to services rendered in Hong Kong during each separate employment since section 8(1B) only applies 'for the purposes of subsection (1A)'. However, whilst it is a precondition that services are rendered in Hong Kong under the relevant employment for section 8(1B) to operate, it does not necessarily follow that the 60-day test only applies to the period of that employment without considering a person's physical presence and work in Hong Kong for the period 1 April to 31 March, which forms the basis period for any year of assessment.

(e) In our view, section 8(1B) provides a statutory relief that exempts a person from salaries tax in circumstances where that person's connection with Hong Kong during the tax year is not significant and can be disregarded for assessment purposes. This purpose would not be satisfied if we accepted the Appellant's interpretation and argument in this case. For instance, if during the year of assessment 1996/97 the Appellant was physically present and worked in Hong Kong for 60 days under the 1995 contract and for 60 days under the 1996 contract, it must follow from the Appellant's contention that he would be totally exempt from salaries tax (providing he was a 'visitor' throughout the year of assessment). Although it may stray from reality, the same result would apply if

the Appellant had a third separate employment during the year of assessment in which he was physically present and worked in Hong Kong for yet another 60 days. We do not accept that this contention should prevail under the scheme of the legislation quoted above, and these examples fortify our decision to reject it.

(f) In CIR v So Chak Kwong, Jack (1986) 2 HKTC 174, Mortimer J stated at page 188:

'The words "not exceeding a total of 60 days" qualify the word "visits" and not the words "services rendered". Were it otherwise [section 8(1B)] would be expressed differently. In order to take the benefit of the Section therefore a Taxpayer must not render services during visits which exceed a total of 60 days in the relevant period.'

(g) It is true that Mortimer J was not addressing the case of any change of employment, but the quotation does lend some support to the conclusion that the 60-day test applies broadly to the basis period for the year of assessment, as distinct from being circumscribed by the period during which the services were rendered. To paraphrase Mortimer J, if that were not the case one would expect section 8(1B) to be expressed differently. Section 8(1B) does not refer to 'visits not exceeding a total of 60 days in the basis period for the year of assessment *for each separate employment*'. Rather, it refers, without qualification, to 'visits not exceeding a total of 60 days *in the basis period for the year of assessment*' (emphasis added). Since the Appellant's physical presence in Hong Kong during his employment with Hong Kong Co throughout the year of assessment 1996/97 exceeded 60 days, and he rendered services during that year in Hong Kong in accordance with the terms of the 1996 contract with Hong Kong Co, the exemption provided by section 8(1B) does not apply.

(h) To bolster this conclusion, we would refer to D143/98, IRBRD, vol 13, 667 where, as did the Appellant, the taxpayer argued that the 60-day test applied to each and every contract of employment *and* that physical presence in Hong Kong prior to the commencement of the relevant contract was irrelevant. In that case, the taxpayer's employment with Company C commenced on 5 February 1996 and from that date until 31 March 1996 he spent the bulk of his time in the Mainland. For the period of employment with Company C the taxpayer obviously spent much less than 60 days in Hong Kong. However, prior to February 1996 he worked in Hong Kong for another company for considerable periods of time. At page 674 the Board of Review dismissed the argument that the taxpayer's employment income from Company C was exempt from salaries tax under section 8(1B) simply by stating: '*During the year in question, the*

Taxpayer was in Hong Kong for no less than 274 days. The exemption clearly does not apply.' [see paragraphs 15(c) and 16(c)]

(i) It is inherent in D143/98 that the 60-day test is not restricted to physical presence computed solely by reference to the period of each separate employment. D143/98 is thus an excellent example of a case where, whilst under a new employment a taxpayer spent less than 60 days in Hong Kong, the taxpayer nonetheless could not take advantage of the 60-day test because during the year of assessment his connection with Hong Kong was significant and could not be disregarded.

(j) Notwithstanding our conclusion, we appreciate that section 8(1B) could arguably be interpreted in the manner pressed upon us by the Appellant. The terms of this provision are not a model of clarity and, indeed, another Board of Review in D37/01, IRBRD, vol 16, 326 has suggested that '*it is perhaps time for the legislature to review this subsection to clarify precisely what is the true intention of this subsection*'.

(k) Given this residual concern, we undertook our own research on the legislative history to assist us in ascertaining the legislative purpose. Section 8(1B) was enacted in 1971 as part of the Inland Revenue (Amendment) Ordinance 1971. We examined the Explanatory Memorandum to the Bill. This did not assist us. We then examined the Legislative Council debates and found the following statement by the Financial Secretary, who indicated that the 60-day test provided for '*relief* of certain categories of employees who in practice render services almost wholly outside [Hong Kong], excepts for visits of short duration' (Hong Kong Hansard, 2 December 1970, page 239). In the resumed debate, the Financial Secretary stated: 'I said, when I introduced the bill, that we intended to maintain the [situs of employment test] as the main general criterion [for determining liability to salaries tax] but to give a general exemption … where a person otherwise chargeable renders services in [Hong Kong] for not more than 60 days in a year of assessment. This applies whether or not there is a Hong Kong contract of employment' (Hong Kong Hansard, 6 January 1971, page 321). Neither of these statements is determinative of an answer to the Appellant's argument – since they do not deal with the case of a change in employment – but in our view they are more consistent with section 8(1B) being intended to apply to visits counted over the whole year of assessment than simply being restricted to the period of the relevant employment.

19. (a) *Argument*. Since the 1996 contract commenced on 1 November 1996, the 60-day rule ought to apply as 5/12 [months] × 60 days = 25 days. On this basis

the Appellant is not liable to tax since he only spent 21 days in Hong Kong during the period 1 November 1996 to 31 March 1997.

(b) *Response*. This interpretation is simply not justified by the terms of section 8(1B). That provision does not admit apportioning the 60-day test in any circumstances. Either the 60-day exemption applies or it does not. We have concluded, at paragraph 18 above, that it does not.

Conclusion

20. In our view, the 60-day test in section 8(1B) does not apply to the Appellant to exempt Sum A from salaries tax since (1) he rendered services in Hong Kong pursuant to the 1996 contract and (2) at all relevant times during the year of assessment 1996/97 he was employed by Hong Kong Co and was physically present in Hong Kong for 142 days. This is sufficient for us to dismiss the appeal and we so order.

21. We wish to thank both parties for their helpful presentations before us. The Appellant in particular addressed us in a very frank and straightforward manner. His presentation of his appeal was such that the real issues in dispute between the parties were clarified and he dealt with them precisely and concisely.