INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D34/01

Salaries tax – whether an employment income arose in or was derived from Hong Kong – apportionment of the income – section 8(1A)(c) of the Inland Revenue Ordinance (' IRO').

Panel: Anthony Ho Yiu Wah (chairman), Peter R Griffiths and Chua Guan Hock.

Date of hearing: 9 March 2001.
Date of decision: 21 May 2001.

The taxpayer was employed by Company B as finance manager stationed in City C, China with effect from 16 January 1995. The taxpayer appealed against the determination of the Commissioner. In that determination, the Commissioner overruled the taxpayer' s objection and confirmed the revised salaries tax assessment. The net chargeable income in question was arrived at by deducting from the total employment income of the taxpayer a part thereof on which he had paid individual income tax in the mainland of China.

The taxpayer' s case is that all his employment income including ' hardship allowance' should be excluded from charges to salaries tax, as all his income was chargeable to tax in the mainland of China. Alternatively the taxpayer argued that since the services rendered by him during the year of assessment 1995/96 were mainly for the China operation, his total income for that year should be apportioned by the ratio of the days he spent in China.

Held:

1. The general rule is that it is necessary to distinguish between a source of income that is fundamentally a Hong Kong employment and a source that is fundamentally an employment outside Hong Kong. In making this distinction the place where services are rendered is irrelevant in deciding whether or not the source is a Hong Kong employment (CIR v Goepfert (1987) 2 HKTC 210 applied).

2. Having regard to the evidence of the case, the Board found that the taxpayer' s employment was a Hong Kong employment, that is, his employment income arose in or was derived from Hong Kong.

3. In order to qualify for an exemption under section 8(1A)(c) of the IRO, there are three requirements namely, that the taxpayer derived income from services overseas; that the income was chargeable to tax of a similar nature to salaries tax;

and that the Commissioner is satisfied that the person has paid tax of that nature in that territory in respect of the income.

4. The Board was of the view that 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 that part of his income, which has been taxed elsewhere. The Board therefore supports the contention that only part of the taxpayer's income, which has been reported to the tax authorities in the mainland of China, would be exempted from tax.

5. Whilst it would be invidious for the Commissioner or the Board to investigate whether the taxpayer had taken advantage of tax planning procedure which has enabled him to reduce the amount of tax which he had had to pay in China, the Commissioner has the power and indeed the duty to ascertain the income which the taxpayer had reported to the Chinese tax authorities before deciding whether section 8(1A)(c)(ii) is satisfied (D56/91, IRBRD, vol 6, 432 applied).

6. The Board found that the hardship allowance was part of the taxpayer's employment income and should not be treated separately just because of the label put on it.

Appeal dismissed.

Cases referred to:

CIR v Goepfert (1987) 2 HKTC 210
D56/91, IRBRD, vol 6, 432

Chan Siu Ying for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The appeal

1. This is an appeal by Mr A ('the Taxpayer') against the determination of the Commissioner of Inland Revenue dated 25 September 2000. In that determination, the Commissioner overruled the Taxpayer's objection and confirmed the revised salaries tax assessment for the year of assessment 1995/96 on the Taxpayer of a net chargeable income of $494,105 with the tax payable thereon of $91,021.

2. The net chargeable income in question was arrived at by deducting from the total employment income of the Taxpayer a part thereof on which he had paid individual income tax in the mainland of China. The Taxpayer's case is that all his employment income including 'hardship allowance' should be excluded from charges to salaries tax (in Hong Kong) as all his income was chargeable to tax in the mainland of China. At the hearing before the Board, he put forward an alternative argument that since the services rendered by him during the year of assessment 1995/96 were mainly for the China operation, his total income for that year should be apportioned by the ratio of the days he spent in China.

The facts

3. The following facts are not in dispute and we find them proved.

4. The Taxpayer was employed by Company B as finance manager stationed in City C, China with effect from 16 January 1995 by a letter dated 15 December 1994 and accepted by the Taxpayer on 16 December 1994 ('the Employment Letter').

5. The Employment Letter contained, inter alia, the following terms and conditions:

- 3. Salary and probation

  Your commencing salary is $47,000 per month (inclusive of the PRC portion as covered by the separate PRC employment letter) …

- 4. Allowance

  You will be paid an allowance of $14,100 per month which is on a 12-month basis for the term of your employment in the People's Republic of China.

- 5. Duties and responsibilities

  You will be responsible for setting up and keeping of proper accounts, treasury function and overall administration of the company's PRC operations.

- 8. Hours of work

  Your working hours shall conform to the local practice of your posting.

- 9. Annual leave

> You are entitled to twenty-two (22 days) working days paid leave per annum. Saturday is considered as half day paid leave. This leave entitlement is only applied to staff station in PRC.

6. In addition to the Employment Letter, a separate PRC employment letter was issued by Company D to the Taxpayer (' the PRC Employment Letter') whereby the Taxpayer was offered the appointment as the finance manager to be stationed in City C, PRC with effect from 16 January 1995 at a monthly salary of $10,000.

7. Company B is a company incorporated in Hong Kong on 20 July 1993. At the relevant time, its business address was Address E in Hong Kong.

8. Company D is a subsidiary of Company B. Both Company D and Company B are wholly owned by Company F (' the Holding Company'), a company incorporated in Hong Kong.

9. The total amount of remuneration paid to the Taxpayer for the year from 1 April 1995 to 31 March 1996 was $794,105 or $783,117 (after deduction of PRC tax) broken down as follows:

	$
Hong Kong salary	455,400
PRC salary	120,000
Hardship allowance	173,600
Year end bonus	45,105
Total	794,105
Less: PRC tax deduction	10,988
	783,117

10. (a) The sum of $794,105 was paid to the Taxpayer by Company B out of which $120,000 was charged to and reimbursed by Company D.

(b) The Taxpayer's monthly salaries were credited into his bank account maintained in Hong Kong through auto-pay.

11. (a) The Taxpayer was responsible for overseeing Company D's finance and accounting operation. His duty included preparation of finance statements, budgets and internal reports.

(b) The Taxpayer worked in Hong Kong during the first three months of his employment in order to familiarize the group's finance and accounting system. He was officially posted to City C with effect from April 1995.

(c) The Taxpayer reported to Company B' s general manager stationed in City C. His subordinates included financing and accounting staff in China and in Hong Kong.

(d) The Taxpayer came back to Hong Kong whenever necessary to attend meetings with the corporate finance division on aspects of group financial system review, auditing, budgeting, tax planning etc.

(e) The Taxpayer took leave during the following periods or on the following days:

Periods/Day	**Number of working days**
27-6-1995 – 29-6-1995	3
28-7-1995	1
6-9-1995 – 22-9-1995	12
16-10-1995 – 19-10-1995	4
22-2-1996 – 4-3-1996	7
	27

(f) The Taxpayer stayed in Hong Kong for business purposes during the following periods:

Periods	**Purpose of the Taxpayer' s staying in Hong Kong**
12-5-1995 – 15-5-1995	Prepare for business trip to Singapore/Kuala Lumpur
24-5-1995 – 25-5-1995	Back to Hong Kong after business trip from Kuala Lumpur
11-11-1995 – 19-11-1995	Meeting with corporate finance
8-12-1995 – 21-12-1995	Meeting with corporate finance
18-1-1996 – 28-1-1996	Meeting with corporate finance
1-2-1996 – 7-2-1996	Meeting with corporate finance

27-3-1996 – 31-3-1996 Meeting with corporate finance

(g) The Taxpayer joined the provident fund scheme of Company B as a member after six months' service. Monthly provident fund contributions were made based on 5% of his total basic salary (that is, $47,000 per month).

12. (a) A total sum of $173,600 was paid to the Taxpayer as hardship allowance, broken down as follows:

Allowance for the period from		$
April 1995 to January 1996	$14,100 x 10	141,000
February 1996 to March 1996	$16,300 x 2	32,600
		173,600

(b) According to the employer of the Taxpayer, hardship allowance was paid to employees who were permanently posted to PRC. On appointment of the Taxpayer, it was agreed that 30% of basic salary was paid as the hardship allowance. This was subject to review at the discretion of the management.

(c) The hardship allowance would not be reduced if the Taxpayer was present in Hong Kong for business trips and annual leave. It was paid to the Taxpayer from his permanent posting to City C (that is, April 1995) until he left the Company on 30 April 1996.

13. The amount of individual income tax paid in the mainland of China on behalf of the Taxpayer was $10,810, computed as follows:

	a	b	c	d	e	f	g	h	i*
Month	Salary in HK$	Exchange rate	Salary in RMB	Allowance in RMB	Taxable income in RMB	Tax rate (%)	Deduction in RMB	Income tax in RMB	Income tax in HK$
4/95	10,000	1.0867	10,867	4,000	6,867	20	375	998	919
5/95	10,000	1.0754	10,754	4,000	6,754	20	375	976	907
6/95	10,000	1.0730	10,730	4,000	6,730	20	375	971	905
7/95	10,000	1.0695	10,695	4,000	6,695	20	375	964	901
8/95	10,000	1.0740	10,740	4,000	6,740	20	375	973	906
9/95	10,000	1.0764	10,764	4,000	6,764	20	375	978	908
10/95	10,000	1.0755	10,755	4,000	6,755	20	375	976	907
11/95	10,000	1.0747	10,747	4,000	6,747	20	375	974	907
12/95	10,000	1.0756	10,756	4,000	6,756	20	375	976	908
1/96	10,000	1.0477	10,477	4,000	6,477	20	375	920	878
2/96	10,000	1.0503	10,503	4,000	6,503	20	375	926	881
3/96	10,000	1.0503	10,503	4,000	6,503	20	375	926	881

Total	120,000		128,291	48,000	80,291		4,500	11,558	10,810

*i = $\frac{(a \times b - d) \times 20\% - g}{b}$

14. According to the records of the Immigration Department, the Taxpayer was present in Hong Kong for a total of 107 days during the year from 1 April 1995 to 31 March 1996. A schedule summarizing the Taxpayer's departure from and arrival at Hong Kong during the relevant period is as follows:

Date of arrival	**Date of departure**	**Number of days in Hong Kong**	
1-4-1995	7-4-1995	7	
12-5-1995	15-5-1995	4	
24-5-1995	25-5-1995	2	
27-6-1995	29-6-1995	3	
28-7-1995	30-7-1995	3	
6-9-1995	24-9-1995	19	
14-10-1995	19-10-1995	6	
11-11-1995	19-11-1995	9	
8-12-1995	21-12-1995	14	
18-1-1996	28-1-1996	11	
1-2-1996	7-2-1996	7	
17-2-1996	4-3-1996	17	
17-3-1996	* N/A	5	(up to 31-3-1996)
		107	

(* continued to stay in Hong Kong after 31-3-1996)

15. The Taxpayer is married and his daughter was born on 17 September 1995. The assessor agreed that the Taxpayer was entitled to child allowance in respect of his daughter and proposed that the salaries tax assessment for the year of assessment 1995/96 be revised as follows:

		$
Total income		794,105
Less: Amount on which tax had been paid in the mainland of China		120,000
Revised assessable income		674,105
Less: Married person's allowance	158,000	
Child allowance	22,000	
		180,000

Revised net chargeable income	494,105
Revised tax payable thereon	91,021

Sworn testimony of the Taxpayer

16. At the hearing before the Board, the Taxpayer gave sworn testimony and was cross-examined by the Commissioner' s representative.

17. The Taxpayer' s evidence may be summarized as follows:

(a) He had two employment contracts with his employer (The Taxpayer cited to the Board various provisions in the Employment Letter and the PRC Employment Letter referred to in paragraphs 4 and 6 above).

(b) His employer told him that they can do some tax saving plan for him and under the two-contract arrangement, there would be tax saving for him in China and Hong Kong as well.

(c) He was not involved in any submission or reporting of income to the local tax bureau in City C, China. All the reporting was done by tax consultants engaged by his employer.

(d) Services rendered by him under his employment were totally related to services in China.

(e) The Taxpayer produced to the Board a copy of his work permit issued by the Chinese authorities and asserted that the type of work permit possessed by him was only for those people who have a permanent job in China and not for short-term visitors. He reiterated that his employment was totally (100%) related to his services in the China operation.

(f) Under cross-examination and in response to questions by the Board, the Taxpayer admitted that (his income) as reported by his employer to the tax authority in China was $10,000 per month and that for the (tax) year in question, his employer reported a total sum of $120,000 to the tax authority in China. The Taxpayer refused to admit that none of the hardship allowance had been reported to the tax authority in China because he did not know whether (the income of) $10,000 per month included hardship allowance or not.

(g) Citing to the Board parts of his employer's letter to the Inland Revenue Department ('IRD') dated 24 May 1997, the Taxpayer reiterated that:

(i) he held a permanent position in City C, China;

(ii) business trips to Hong Kong was expected to be minimal and the length of stay in Hong Kong was not likely to exceed 60 days a year;

(iii) he did not render service to his employer in Hong Kong during the year of assessment 1995/96;

(iv) he was not normally required to attend meetings or report to Hong Kong office in relation to his work in China;

(v) his superior was also based in City C, China.

(h) In response to questions by the Board, however, the Taxpayer admitted that in the year of assessment 1995/96, he actually spent 107 days in Hong Kong because he had to copy the computer system from Hong Kong for the China operation and because he had to report to the chief financial officer in Hong Kong about the progress of the establishment in China.

The law

18. Section 68(4) of the IRO provides that '*the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant*'.

19. Section 8(1) of the IRO provides that '*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; and

(b) …'

20. Section 8(1A)(c) of the IRO provides that:

'*For the purposes of this Part, income arising in or derived from Hong Kong from any employment –*

(a) …

(b) …

(c) excludes income derived by a person from services rendered by him in any territory outside Hong Kong where –

(i) by the laws of the territory where the services are rendered, the income is chargeable to tax of substantially the same nature as salaries tax under this Ordinance; and

(ii) the Commissioner is satisfied that that person has, by deduction or otherwise, paid tax of that nature in that territory in respect of the income.'

21. The general rule established as a result of a series of Board of Review decisions, and confirmed by the decision in CIR v Goepfert (1987) 2 HKTC 210, is that it is necessary to distinguish between a source of income that is fundamentally a Hong Kong employment and a source that is fundamentally an employment outside Hong Kong. In making this distinction the place where services are rendered is irrelevant in deciding whether or not the source is a Hong Kong employment.

Analysis of the case

22. In the present case, it is quite clear that the Taxpayer' s employment was a Hong Kong employment, that is, his employment income arose in or was derived from Hong Kong, having regard to the following factors:

(a) the contract of employment was entered into in Hong Kong;

(b) his employer was a corporation incorporated in and with its business address in Hong Kong;

(c) the remuneration was paid to him in Hong Kong;

(d) he was a member of a Hong Kong provident fund scheme established by his employer; and

(e) his remuneration (except for a total sum of $120,000 reimbursed by his employer' s subsidiary in China) was paid by the employer which was a Hong Kong company or establishment.

23. Since the Taxpayer did not render outside Hong Kong all the services in connection with his employment as he did come back to Hong Kong to attend meetings with the corporate finance division and he did stay in Hong Kong for business purposes for seven occasions during the year of assessment 1995/96 (see paragraph 11(d) and 11(f) above), section 8(1A)(b) of the IRO

is not applicable. Furthermore, since the Taxpayer was apparently not a visitor to Hong Kong and in any event his stay in Hong Kong during the year of assessment 1995/96 exceeded 60 days (see paragraphs 14 and 17(h) above), section 8(1B) of the IRO is not applicable to this case.

24. By reason of the matters stated in paragraphs 22 and 23, salaries tax liability will apply to the Taxpayer' s employment income except insofar as such income derived from services outside Hong Kong is liable to tax and has been taxed outside Hong Kong within the meaning of section 8(1A)(c) of the IRO. In this connection, we agree with the submission by the IRD that to qualify for an exemption under section 8(1A)(c) of the IRO, there are three requirements namely:

(a) that the taxpayer derived income from services overseas;

(b) that the income was chargeable to tax of a similar nature to salaries tax; and

(c) that the Commissioner is satisfied that the person has paid tax of that nature in that territory in respect of the income.

25. In this case, the IRD accepted that the Taxpayer had derived income from services outside Hong Kong and that a part of the Taxpayer' s income having been reported to the tax authorities in the mainland of China was chargeable to tax in China which was of a similar nature to salaries tax and that this part of the income in the sum of $120,000 would be exempted. The IRD did not agree that the whole of the Taxpayer' s income would be exempted from tax nor did the IRD agree that exemption be granted on the basis of the days spent by the Taxpayer in the mainland of China.

26. The Taxpayer has contended that ' under PRC Law, his income was chargeable for PRC tax purpose and this would be sufficient for Hong Kong tax exclusion purpose since it complies with section 8(1A)(c)(i)' . The Taxpayer has further contended (by way of alternative argument) that since the services rendered by him during the year of assessment 1995/96 were mainly for the China operation, his total income for that year should be apportioned by the ratio of the days he spent in China. We do not accept either of these contentions. First, section 8(1A)(c) has two limbs, namely (i) and (ii) and both limbs have to be satisfied before the Taxpayer is entitled to exemption. Secondly, we are of the view that 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. We therefore support the contention of the IRD that only part of the Taxpayer' s income amounting to $120,000 which has been reported to the tax authorities in the mainland of China would be exempted from tax.

27. The Taxpayer has drawn our attention to the following passages in case of D56/91, IRBRD, vol 6, 432 where the Board said:

> '*It is not for us as a Board of Review sitting in Hong Kong to consider or pass judgment on taxation matters in the Peoples' Republic of China.*'

> '*We believe that it would be invidious for the Commissioner or ourselves to investigate further into whether or not a person has or has not been correctly taxed according to the laws of an overseas territory.*'

28. In reliance on the aforesaid passages in the case of D56/91, the Taxpayer further submitted that since his hardship allowance was for services rendered in PRC, whether or not he had paid tax to PRC for the hardship allowance should not affect the exclusion of this allowance from Hong Kong tax.

29. We agree completely with the views expressed by the Board as cited in paragraph 27 above. We do not however agree that the Taxpayer can derive any assistance to his case from the passages cited. Whilst it would be invidious for the Commissioner or ourselves to investigate whether the Taxpayer has taken advantage of tax planning procedure which has enabled him to reduce the amount of tax which he had had to pay in China, the Commissioner has the power and indeed the duty to ascertain the income (including hardship allowance, if any) which the Taxpayer had reported to the Chinese tax authorities before deciding whether section 8(1A)(c)(ii) is satisfied. Indeed, at the hearing we have pointed out to the Taxpayer that in the case of D56/91, the appellant had declared the whole amount of his hardship allowance for tax purposes in China and that the Board's comment cited by the Taxpayer that '*it would be invidious for the Commissioner or ourselves to investigate further into whether or not a person has or has not been correctly taxed according to the laws of an overseas territory*' was in fact preceded by the following comment '*it should not be necessary to investigate beyond the fact the Taxpayer in question has duly declared for assessment purposes the whole of the income in question and that the tax authorities have duly assessed and taxed the whole of that income according to their practices and procedures.*' In this case, the Taxpayer had not declared for assessment purposes in the mainland of China the whole of his employment income. He only declared a total sum of $120,000.

Conclusion

30. Having considered all the evidence and the facts before us, we have reached the following conclusions:

(a) The hardship allowance was part of the Taxpayer's employment income and should not be treated separately just because of the label put on it.

(b) The Taxpayer's employment was a Hong Kong employment. As such, salaries tax liability would be applicable except insofar as income derived from services outside Hong Kong was subject to tax outside Hong Kong and the Commissioner is satisfied that such tax had been paid.

(c) For the year of assessment 1995/96, the Taxpayer had reported part of his income in the sum of $120,000 to the tax authorities in the mainland of China. Only this amount should be exempted from tax in Hong Kong and the IRD had already given due allowance for this amount when calculating the net chargeable income of the Taxpayer in this case.

31. We therefore dismiss the Taxpayer' s appeal and confirm the assessment.