Case No. D35/09

Salaries tax – whether or not only that part of the Taxpayer's employment income attributable to his services in Hong Kong be chargeable to salaries tax under section 8(1A)(a) of the Inland Revenue Ordinance ('IRO') – source of employment income – totality of facts test – sections 8(1), 61 and 68(4) of the IRO.

Panel: Colin Cohen (chairman), Leung Lit On and Arthur Mcinnis.

Date of hearing: 12 August 2009.
Date of decision: 12 October 2009.

The Taxpayer entered into a contract of employment with Company F on 4 October 2004. Under that contract, the Taxpayer was to serve Company F as an Executive Vice-President of the Product H Division. The Taxpayer was in Hong Kong on the day the contract was signed. By a letter dated 1 June 2005, Company G offered to employ the Taxpayer as Head of Product H Division with effect from 1 June 2005. In the relevant years of assessment, the Taxpayer performed his duties both in and outside Hong Kong. He was in Hong Kong for more than 60 days for each year of assessment. The Taxpayer claimed in his tax returns for the years of assessment 2004/05 to 2006/07 that his income should be wholly or partly excluded from salaries tax assessments on the ground that he spent less than 50% of his time in Hong Kong or that he was employed by Company G which is a non-Hong Kong company.

By the Determination, the Deputy Commissioner rejected the Taxpayer's claim and held that his full income was chargeable to salaries tax. The issue for the Board to consider was whether only that part of the Taxpayer's employment income attributable to his services in Hong Kong be chargeable to salaries tax under section 8(1A)(a) of the IRO.

Held:

1. The Board was of the view that when deciding a person's liability to pay salaries tax, it is first necessary to determine the source of his employment income, that is, is it a Hong Kong source or a non-Hong Kong source? Again, it is settled law that in deciding the issue, all the relevant factors in respect of each particular case have to be considered. Therefore, it is a totality of facts test that the Board needed to review and consider. Hence, the place where a person may have actually rendered his service is irrelevant in such a consideration (CIR v George Andrew Goepfert 2 HKTC 210 and Lee Hung Kwong v CIR 6 HKTC 543 considered).

2. If a person's income arises in or is derived from Hong Kong and is caught by the basic charging section, section 8(1), therefore, the full amount of income will be chargeable to salaries tax. There is therefore no room for apportionment of income.

3. Section 61 of the IRO can be applicable when two conditions are satisfied: (a) If there is a transaction which reduces or would reduce the amount of tax payable by any person; and (b) such transaction is artificial or fictitious or that any disposition is not given effect to.

4. Having considered the evidence, the Board had no difficulties in coming to the conclusion that the Taxpayer had failed to discharge the burden of proof in establishing that his employment for Company F and Company G should be assessed in a time apportionment basis under section 8(1A)(a) of the IRO and pursuant to section 61 of the IRO, the change of employment to Company G could very well be disregarded and the Taxpayer should be assessed accordingly.

Appeal dismissed.

Cases referred to:

CIR v George Andrew Goepfert 2 HKTC 210
Lee Hung Kwong v CIR 6 HKTC 543
Seramco Trustees v Income Tax Commissioner [1977] AC 287
Cheung Wah Keung v CIR [2002] 3 HKRLD 773

Taxpayer in person.
Chan Tak Hong for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal by Mr A ('the Taxpayer') against the Determination by the Deputy Commissioner of Inland Revenue ('the Deputy Commissioner') dated 5 May 2009 ('the Determination') in respect of the additional salaries tax assessment for the year of assessment 2004/05 and salaries tax assessments for the years of assessment 2005/06 and 2006/07.

2. The issue for the Board to consider is whether only that part of the Taxpayer's employment income attributable to his services in Hong Kong be chargeable to salaries tax under section 8(1A)(a) of the Inland Revenue Ordinance ('IRO').

The facts and the Taxpayer's evidence

3. Company B is incorporated in Country C and is listed on the Stock Exchange in Country D. It is based in Hong Kong at Address E. Company F and Company G are wholly-owned subsidiaries of Company B. Company F was incorporated in Hong Kong and has been carrying on business in Hong Kong. Its business address is also at Address E.

4. The Taxpayer entered into a contract of employment with Company F on 4 October 2004. Under that contract, the Taxpayer was to serve Company F as an Executive Vice-President of the Product H Division. The Taxpayer was in Hong Kong on the day the contract was signed.

5. In October 2004, the Taxpayer applied to the Immigration Department for entry to Hong Kong to take up employment and in turn, Company F sponsored the Taxpayer's application in a capacity of an employer.

6. By a letter dated 1 June 2005, Company G offered to employ the Taxpayer as Head of Product H Division with effect from 1 June 2005. In the relevant years of assessment, the Taxpayer performed his duties both in and outside Hong Kong. He was in Hong Kong for more than 60 days for each year of assessment. The Taxpayer claimed in his tax returns for the years of assessment 2004/05 to 2006/07 that his income should be wholly or partly excluded from salaries tax assessments on the ground that he spent less than 50% of his time in Hong Kong or that he was employed by Company G which is a non-Hong Kong company. Company G was incorporated in Country I.

7. By the Determination, the Deputy Commissioner rejected the Taxpayer's claim and held that his full income was chargeable to salaries tax.

8. The Taxpayer gave evidence before us. He stated that he was recruited by Company F to develop and expand their product H business throughout the world. Previously, Company F had a small business based on exports from Country J and Country K to Country L and South East Asia.

9. He told us that when he first came to Hong Kong, he came on his own and his family remained in London. He stayed in a rented accommodation.

10. He advised us that he travelled extensively during his first 6 months of employment. He was embarking upon fact finding missions in an attempt to see what could be done to expand Company F's worldwide product H business.

11. He advised us that he reported directly to Mr M and Mr N. He accepted that the various letters that were sent to the Director of Immigration clearly set out his duties.

12. In particular, a letter dated 29 October 2004 indicated that the reason for his employment was '….. Due to the business expansion and in order to cope with our

development, we are looking for highly qualified individual to support our business strategy. This is a new position to oversee the global [product H] trading activities of [Group P]. The job duties of this position include that previously handled by our Senior Vice President – [Product H], [Mr Q] [HKID No. x-xxxxxx(x)] who resigned as of October last year. His position has not been filled as there is no local applicant who can either match our standard or be available shortly. Through referral and taking into consideration of our business expansion plan, we decided to recruit an executive with more global experience to be in charge of our [Product H Division]. [Mr A] has demonstrated to us that he is the ideal candidate. …..'. Attached to the letter dated 29 October 2004 was a document headed 'Job Description' whereby it stated that his position was an Executive Vice President – Product H Division and in turn, set out details of his main responsibilities.

13. However, the Taxpayer having commenced work with Company F, he advised Company F that the product H world was changing and to survive, they needed to restructure their operations. He in turn indicated to them that he wished to be based in London or Geneva. However, he was informed that Company F wished him to remain in Hong Kong and he was to be available to deal with all relevant issues and to have access to senior management.

14. However, he was then informed that he would be required to enter into a new contract of employment dated 1 June 2005 with Company G. Company G was a company incorporated in Country I. He would report to Mr R. In turn, he then made arrangements for his family to be relocated to Hong Kong. The employment letter dated 1 June 2005 provided him with some further housing benefits. At first, he indicated to us that the notice period was reduced from three months to one month. However, when the Board pointed out to him that the notice period was indeed exactly the same, that is, 3 months, he accepted that this was correct. He informed us that he rented a new apartment in Hong Kong and his children attended school in Hong Kong.

15. His attention was also drawn to the relevant documents that were submitted to the Director of Immigration and he accepted that those documents were indeed accurate and correct although it was not he who wrote to the Director of Immigration. However, it is clear from a letter dated 21 June 2006 that the Director of Immigration was informed that there was a change of employment to an overseas company within the same group. In that letter, it stated as follows:

> 'We are writing to inform you that since [Mr A] has undertaken broader responsibilities in our global operation, he has therefore been transferred to the employment of [Company G], an overseas wholly owned subsidiary of [Group P], on 1 June 2005.
>
> However, the sponsor for [Mr A's] work visa is still [Company F]. [Company G] and [Company F] are entities under the same group and we have enclosed a letter from our company secretary for your reference.
>
> …..'

Attached to that letter was an organization chart of Company F as well as a Job Description. In that Job Description, it stated the job purpose as:

> 'The head of the [Product H division] is responsible for the expansion and supervision of the [product H] trading activities in [Group P] across the world.'

Various responsibilities were set out.

16. He advised us that he travelled extensively and spent a considerable amount of his time with the relevant offices throughout the world including dealing with he called 'P/L offices' which he defined as profit and loss operations. In particular, he drew to our attention the fact that the office in Country S would be responsible for the execution and signing of various product H contracts both purchasing and selling. He also indicated that his task and duties were to expand the operations in respect of offices that either had been previously established or were about to be established.

17. During the course of cross-examination, his attention was drawn to a letter dated 4 December 2008 written to the Director of Immigration and which in turn, was signed by himself. However, he indicated that although he signed that letter, it was drafted by the Human Resources Department of Company F and he was not aware as to the various enclosures that were attached to that letter. In particular, he took the view that the relevant attachment dated 11 May 2005 and the relevant Job Description when he was under the employment of Company G was in his view inaccurate. However, when pushed, he had to accept that this was a letter he signed and indeed, that could be no reason as to why the contents of that letter should not accurately reflect the true position in respect of his employment.

18. His attention was also drawn to an interview which he attended at the Inland Revenue Department ('IRD') on 22 April 2009. He candidly confirmed to us that the change of employment to Company G was a scheme which he said was developed by Group P in 2005 based on the advice of an external consultant. He indicated to the IRD that the purpose of this scheme was to save 'tax of the top management people'.

19. He confirmed that the note of interview was accurate.

20. However, he again emphasized to us that he was clearly of the view that he was hired at a senior level within Group P and a substantial part of his duties were carried out outside of Hong Kong.

21. However, he accepted that throughout his employment with Company F and Company G, he only had one name card, which was in the name of Company F and which clearly showed that he described him as an Executive Vice President of Product H, he gave his address at Address E and had a direct phone line in Hong Kong. He also confirmed that he was paid by Company F from the company's bank account in Hong Kong in respect of

his employment with Company F and in respect of his employment with Company G although he was paid out of Hong Kong, he accepted that his remuneration was wholly charged back to Company F.

22. During the course of his evidence, he again emphasized to us that the IRD were only focusing on documents and did not take into account exactly what he did, that is, he spent a considerable amount of his time abroad working for both Company G and Company F and hence, in turn, he felt that he was entitled to a time apportionment for his time spent out of Hong Kong when he worked on behalf of both Company F and Company G.

23. He asserted that only the income attributable to his services actually rendered in Hong Kong should be taxed for both of his employment with Company F and Company G.

24. Miss Chan helpfully produced to us in her written submissions a short table setting out what the position would be if his income was assessed as suggested by the Taxpayer:

‘

	2005/06	2006/07
	$	$
Tax payable		
Per determination – no time apportionment	484,340	518,669
Time apportionment for income from Company G	334,712	261,828
Tax avoided	149,628	256,841
	31%	49%’

The charging of salaries tax

25. Section 8(1) of the IRO provides that salaries tax shall be charged on every person in respect of his income arising in or derived from Hong Kong from any office or employment of profit and any person.

26. Section 8(1A)(a) of the IRO provides that income arising in or derived from Hong Kong from any employment includes income derived from services rendered in Hong Kong including leave pay attributable to such services.

27. Section 8(1A)(b)(ii) excludes from charge to salaries tax income derived from services rendered by a person who renders outside Hong Kong all the services in connection with his employment.

28. Section 8(1B) of the IRO provides that 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.

29. Our attention was drawn to the various authorities and in particular, we were

referred to CIR v George Andrew Goepfert 2 HKTC 210 ('the Goepfert case'), Macdougall J at pages 236 and 238 stated as follows:

> *'As a matter of statutory interpretation I am unable to escape the conclusion that, although sec. 8(1) must be construed in the light of and in conjunction with section 8(1A), section 8(1A)(a) creates a liability to tax additional to that which arises under section 8(1). It is an extension to the basic charge under section 8(1). If it were otherwise section 8(1A)(a) would be virtually otiose and section 8(1A)(b) completely unnecessary'*
>
> *'If during a year of assessment a person's income falls within the basic charge to salaries tax under section 8(1), his entire salary is subject to salaries tax wherever his services may have [been] rendered, subject only to the so called "60 days rule" that operates when the taxpayer can claim relief by way of exemption under section 8(1A)(b) as read with section 8(1B). Thus, once income is caught by section 8(1) there is no provision for apportionment.*
>
> …..
>
> *On the other hand, if a person, whose income does not fall within the basic charge to salaries tax under section 8(1), derives income from employment in respect of which he rendered services in Hong Kong, only that income derived from the services he actually rendered in Hong Kong is chargeable to salaries tax. Again, this is subject to the "60 days rule".'*

30. In Lee Hung Kwong v CIR 6 HKTC 543 ('the Lee Hung Kwong case'), Deputy High Court Judge To concurred with the view of Macdougall J.

31. In the Goepfert case, Macdougall J also stated at 236 as follows:

> *'It follows that the place where the services are rendered is not relevant to the enquiry under section 8(1) as to whether income arises in or derived from Hong Kong from any employment. It should therefore be completely ignored.'*

32. We agree with the submissions of Miss Chan that the correct approach in identifying the source of income is as set out by Macdougall J in the Goepfert case at 237:

> *'Specifically, it is necessary to look for the place where the income really comes to the employee, that is to say, where the source of income, the employment, is located. As Sir Wilfrid Greene said, regard must first be had to the contract of employment.*
>
> *This does not mean that the Commissioner may not look behind the appearances to discover the reality. The Commissioner is not bound to accept as conclusive, any claim made by an employee in this connexion. He is entitled*

> *to scrutinize all evidence, documentary or otherwise, that is relevant to this matter.*
>
> …..
>
> *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. …..'*

33. Deputy High Court Judge To in the Lee Hung Kwong case again accepted that the place of service was irrelevant for determining the source of income from employment and the totality test was the test for the purpose. Hence, contract of employment, place of payment, residence of the employer were some of the factors to be taken into consideration but none of them were conclusive.

34. We are of the view that when deciding a person's liability to pay salaries tax, it is first necessary to determine the source of his employment income, that is, is it a Hong Kong source or a non-Hong Kong source? Again, it is settled law that in deciding the issue, all the relevant factors in respect of each particular case have to be considered. Therefore, it is a totality of facts test that we need to review and consider. Hence, the place where a person may have actually rendered his service is irrelevant in such a consideration.

35. If a person's income arises in or is derived from Hong Kong and is caught by the basic charging section, section 8(1), therefore, the full amount of income will be chargeable to salaries tax. There is therefore no room for apportionment of income.

Certain transactions to be disregarded

36. Section 61 of the IRO clearly provides that where an assessor is of opinion that a transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the person concerned shall be assessable accordingly. Our attention was drawn to Seramco Trustees v Income Tax Commissioner [1977] AC 287 and Cheung Wah Keung v CIR [2002] 3 HKRLD 773. In Seramco, the Privy Council stated as follows:

> *'….. It is only when the method used for dividend stripping involves a transaction which can properly be described as "artificial" or "fictitious" that it comes within the ambit of section 10(1). Whether it can properly be so described depends upon the terms of the particular transaction that is impugned and the circumstances in which it was made and carried out.*

> *"Artificial" is an adjective which is in general use in the English language. It is not a term of legal art; it is capable of bearing a variety of meanings according to the context in which it is used. In common with all three members of the Court of Appeal their Lordships reject the trustees' first contention that its use by the draftsman of the subsection is pleonastic, that is, a mere synonym for "fictitious". A fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out. "Artificial" as descriptive of a transaction is, in their Lordships' view a word of wider import. Where in a provision of a statute an ordinary English word is used, it is neither necessary nor wise for a court of construction to attempt to lay down in substitution for it, some paraphrase which would be of general application to all cases arising under the provision to be construed. Judicial exegesis should be confined to what is necessary for the decision of the particular case. Their Lordships will accordingly limit themselves to an examination of the shares agreement and the circumstances in which it was made and carried out, in order to see whether that particular transaction is properly described as "artificial" within the ordinary meaning of that word.'*

37. We also refer to Mr Justice Woo in the Cheung Wah Keung case. At paragraph 41, he stated that whether a commercially unrealistic transaction must necessarily be regarded as being 'artificial' depends on the circumstances of each particular case and that commercial realism can be one of the considerations for deciding artificiality:

> *'41. The term "commercially unrealistic" appears in CIR v Howe (1977) 1 HKTC 936 at p.952 in the sense of "unrealistic from a business point of view". We are of the view that whether a transaction which is commercially unrealistic must necessarily be regarded as being "artificial" depends on the circumstances of each particular case. We agree with the submission of Mr Cooney, however, that commercial realism or otherwise can be one of the considerations for deciding artificially. In the present case, the Board found as a fact that there was no "commercial reality in the transaction" and that there "simply was no commercial sense in the transaction"; thus it was open to the Board to reach the conclusion that the transaction was artificial under section 61.'*

38. Hence, in our view, section 61 can be applicable when two conditions are satisfied:

(a) If there is a transaction which reduces or would reduce the amount of tax payable by any person; and

(b) Such transaction is artificial or fictitious or that any disposition is not given effect to.

Burden of proof

39. 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 Taxpayer.

Our analysis

40. We have no hesitation in concluding that the Taxpayer's employment with Company F was unequivocally and clearly sourced in Hong Kong. It is clear that Company F was a company incorporated in Hong Kong, carried out its business in Hong Kong and one would have regard to the information that was provided to the Director of Immigration in support of the Taxpayer's application for a visa. The employment contract between Company F and the Taxpayer was made on 4 October 2004. The Taxpayer was in Hong Kong on that date. We also accept that it is quite clear that the employment contract clearly shows a clear connection to Hong Kong and in particular, the contract was governed in accordance with the laws of Hong Kong. It is also clear that in the letter requesting an early grant of the Taxpayer's work permit was for him to commence employment in Hong Kong. Although the Taxpayer travelled extensively and spent a considerable time rendering service outside Hong Kong, there can be no doubt in our view that the totality of his contract was here in Hong Kong and his income was clearly Hong Kong sourced.

41. We have also considered carefully the Taxpayer's employment with Company G. Again, the Taxpayer's position that his role and scope of responsibility expanded significantly from a regional role to a global role upon transfer of employment to Company G, one must have regard to the actual source and relocation of his income. As previously stated, we also refer to paragraph 12 above whereby we quoted Company F's letter to the Director of Immigration dated 29 October 2004.

42. The Job Description which was attached to the Taxpayer's application for a visa gives a similar description of Company F's business and his tax duties when he became Executive Vice President of the Product H Division. Indeed, as we have previously stated above, the Job Description of Heads of Product H of Company F furnished by the Taxpayer in reply to the assessor's enquiries supports the documents filed with the Director of Immigration. The Job Description indicates that the Taxpayer's Head of the Product H Division was:

> 'responsible for expansion and supervision of the [product H] trading activities in [Group P] across the world'.

He was to open trading offices in key markets such as Country T, Country U, Country V, Europe, Country W, Country Y and Country Z. It is also clear when the Taxpayer commenced employment in October 2004, Company F was already doing business through its offices in the Far East, Western and Eastern Europe and through agents in other parts of the world. A comparison of the various Job Descriptions of Head of the Product H Division of Company F and Company G respectively does not show any real expansion of duties from a regional role to a global role. We have no difficulties in accepting the submissions of

Miss Chan that the change of employment due to expansion and scope of duties should be rejected. Hence, we conclude that his income from Company G was clearly Hong Kong sourced.

43. We also have no hesitation in coming to the conclusion that the change of employment from Company F to Company G was indeed artificial or fictitious in the terms of section 61 of the IRO and as such, should be ignored when deciding the Taxpayer's liabilities to salaries tax. Our reasons for this are as follows:

(a) We have no difficulties in concluding that the reason for change of employment, that is, expansion and scope of responsibility from a regional role to a global role was unconvincing.

(b) Despite the purported change of employment, the Taxpayer remained based in Company F's address in Hong Kong, he continued to use the name card when introducing himself to his clients and doing business. Notwithstanding the alleged expansion and scope of his responsibilities, there was no substantial change to the Taxpayer's remuneration package, the salary remained as fixed at US$250,000 and he was entitled to a discretionary bonus.

(c) According to Company F, the Taxpayer's remuneration under Company G was wholly charged back to Company F for the relevant years of assessment.

(d) Finally, in a meeting with the senior assessor, the Taxpayer frankly admitted the change of employment was a tax avoidance scheme provided by Group P to assist its senior staff in reducing their tax liabilities.

Therefore, we have no difficulties in concluding that pursuant to section 61 of the IRO, the change of employment to Company G could very well be disregarded and the Taxpayer should be assessed accordingly. Hence, in our view, the Taxpayer should be assessed as if he remained under the employ of Company F throughout the period and there was no change of employment.

Conclusion

44. Hence, having regard to the above reasons, we have no difficulties in coming to the conclusion that the Taxpayer had failed to discharge the burden of proof in establishing that his employment for Company F and Company G should be assessed in a time apportionment basis under section 8(1A)(a) of the IRO. We therefore dismiss the appeal.