

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D35/99

**Salaries Tax** – ascertaining the number of employment contract and the source of income – the Commissioner is entitled to scrutinize all evidence, documentary or otherwise, that is relevant to the matter concerned – sections 8(1), 12(1)(a) and 68(4) of the Inland Revenue Ordinance.

Panel: Ronny Wong Fook Hum SC (chairman), Dennis Law Shiu Ming and Vernon F Moore.

Date of hearing: 22 April 1999.

Date of decision: 16 July 1999.

The taxpayer entered into two employment agreements with Company A and Company B respectively, both dated initially 23 March 1989 but amended to 11 May 1989. The two employment agreements were witnessed by a Mr H, then managing director of Company A, which was a private company incorporated in Hong Kong and was a wholly owned subsidiary of Company B, a company incorporated in Country C. Company D, a company also incorporated in Country C, was Company A's ultimate holding company. The taxpayer was in Hong Kong on 11 May 1989. There was no dispute in relation to the time spent by the taxpayer in Hong Kong during the relevant periods, which varied from 198 to 260 days. The taxpayer appealed against the assessment on the ground of excessive and/or incorrect. The two issues were, firstly, whether there was only one contract of employment; and if so, whether that contract of employment was sourced in Hong Kong.

#### **Held:**

- (1) By virtue of section 68(4) of the IRO, the onus was on the taxpayer to prove that the assessment appealed against was excessive or incorrect as the same exceed the income that he derived from services rendered in Hong Kong. For this purpose the taxpayer must substantiate his case by credible evidence. However, he made no attempt to discharge this onus.
- (2) The Board viewed the evidence of the taxpayer with reservations. A cardinal feature of this case was the complete contrast in the role of the taxpayer as painted by correspondence between the Revenue and Company A on the one hand and Company B / the taxpayer on the other. Apart from the bare denials by the taxpayer, no attempt was made to call any one from Company A to explain the discrepancies. The burden on the taxpayer under section 68(4) was not a heavy one but efforts must be made to discharge the same.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (3) The Board was of the view that apart from ascertaining the source of income, in arriving at findings of fact, the Commissioner was not bound to accept as conclusive, any claim made by an employee. He was entitled to scrutinize all evidence, documentary or otherwise, that was relevant to the matter concerned: CIR v Goepert 2 HKTC 210.
- (4) The Board was of the view that for the period after 11 May 1989, there was only one contract of employment and the was between the taxpayer and Company A.
- (5) The principles outlined in CIR v Goepfert were well known. The expression 'income arising in or derived from Hong Kong' in section 8(1) of the IRO was referable to the locality of the source of income and not the place where the duties of the employee were performed. The place where the service were rendered was not relevant to the enquiry under section 8(1) as to whether income arises in or was derived from Hong Kong from any employment and should be completely ignored.
- (6) The Board was of the view that the one contract of employment that the Board found was sourced in Hong Kong on the grounds that:
  - (i) The contract of employment was a continuation of the arrangement as embodied in the letter of 22 May 1984 addressed to the taxpayer in Hong Kong.
  - (ii) Company A, which was incorporated in Hong Kong, was the employer. The taxpayer accepted in cross-examination that he was based in Hong Kong and he did some work for Company A whilst he was in Hong Kong.
  - (iii) The taxpayer's remuneration was paid to him partly in Hong Kong and partly outside Hong Kong.
  - (iv) The taxpayer was responsible for the whole of Company A. All his trip expenses were paid by Company A and booked as travelling expenses. Company A also provided him with accommodation in Hong Kong.
- (7) On the assumption that there were two contracts of employment and Agreement 1 was sourced outside Hong Kong, the Board agreed with the Commissioner that the position falls to be considered under section 8(1A)(a) of the IRO.

**Appeal dismissed.**

Cases referred to:

## INLAND REVENUE BOARD OF REVIEW DECISIONS

Ramsay v IRC [1981] STC 174  
IRC v McGuckian [1977] STC 908  
Furniss v Dawson [1984] 2 WLR 226  
D52/86, IRBRD, vol 2, 314  
Patcorp Investments Ltd v FTC 76 ATC 4225  
CIR v Goepfert 2 HKTC 210

Chiu Kwok Kit for the Commissioner of Inland Revenue.  
Taxpayer represented by his representative Neil Thomson.

### **Decision:**

### **Background**

1. Company A is a private company incorporated in Hong Kong on 26 January 1979. At all relevant times Company A was a wholly owned subsidiary of Company B, a company incorporated in Country C. Company D, a company also incorporated in Country C, was Company A's ultimate holding company.
2. At all material times, Company A carried on an import and export business. 50% of its sales was to its head office in Country C. In January 1982, it set up a liaison office in Region E.
3. By a letter dated 22 May 1984 from Mr F (the then managing director of Company B addressed to the Taxpayer in Hong Kong, the Taxpayer's appointment with Company A for a trial period between 21 May 1984 to 31 December 1984 was confirmed. During this trial period, the Taxpayer's total salary package was \$25,000 per month. The Taxpayer was further informed that in the event of a permanent position being offered to him after the trial period, a new package will be negotiated to yield not less than \$30,000 per month plus medical cover and economy class air ticket for 1 holiday to Country C.
4. By letter dated 19 September 1988, Mr F informed the Taxpayer of his appointment to Company G in Country C. The letter was written on paper bearing the letter head of Company B. Company A's Hong Kong address was referred to as 'Far East head office'. Company A's address in Region E was referred to as 'Region E representative office'. They were both described as 'A member of Company D.'
5. According to the employer's return of Company A for the year ended 31 March 1989, the Taxpayer was employed as its director for the period between 1 April 1988 and 31 March 1989 earning a total of \$72,000 during this period.
6. By letter dated 27 January 1989, Messrs Arthur Young commented on a draft employment contract sent to them. The comments were given 'for the purpose of entering

## INLAND REVENUE BOARD OF REVIEW DECISIONS

into a dual contract arrangement' on the basis that the relevant employee is required to travel extensively outside Hong Kong to serve the group companies. 'Under the Hong Kong contract, the employee would be based in Hong Kong and would devote the whole of his working time when serving under the Hong Kong contract in Hong Kong. Under the non-Hong Kong contract, the employee's place of work is based outside Hong Kong and he would also devote the whole of his working time when serving under the non-Hong Kong contract outside Hong Kong.'

7. The Taxpayer entered into two agreements both dated initially 23 March 1989 but amended to 11 May 1989. The two agreements were witnessed by Mr H, then managing director of Company A. The Taxpayer was in Hong Kong on 11 May 1989.

8. The first agreement ['Agreement 1'] was made with Company B.

- (a) Clause 2.1 provided that 'Company B shall employ the Taxpayer and the Taxpayer shall serve Company B as overseas executive ...'
- (b) Clause 2.2 provided that 'the Taxpayer shall ... devote the whole of his working time skill and abilities when working under this agreement to the carrying out of his duties hereunder ...'.
- (c) Clause 2.3 provided that 'The Taxpayer shall be based wholly outside Country C and outside his normal base of Hong Kong and shall travel to such locations at such times as shall be necessary or desirable for the proper performance by the Taxpayer of his duties.'
- (d) Clause 3.1 provided that the remuneration of the Taxpayer shall be a 'basic salary at the rate of \$240,000 per annum payable by equal monthly instalments in arrears on or about the last day of each calendar month. If the Taxpayer so wishes such sum may be converted into Country C's currency at the rate of exchange prevailing at the date of signature hereof and the monthly instalments payable hereunder shall remain constant until the next salary review date regardless of any fluctuations in the rates of exchange.'
- (e) Clause 14 provided that 'The agreement shall be governed by and construed in accordance with the law of Hong Kong'.
- (f) According to the schedule annexed to this agreement, employment with Company B commenced on 1 December 1988. The previous employer of the Taxpayer was Company A and he commenced his employment with Company A on 31 May 1984.

9. The second agreement ['Agreement 2'] was made with Company A.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (a) Clause 2.1 provided that ‘Company A shall employ [the Taxpayer] and the Taxpayer shall serve Company A as a director of Company A and as managing director of its M & S division ...’.
- (b) Clause 2.2 provided that ‘The Taxpayer shall ... devote the whole of his working time skill and abilities when working under this agreement to the carrying out of his duties hereunder ...’.
- (c) Clause 2.3 provided that ‘The Taxpayer shall be based in Hong Kong for the performance of his duties under this agreement.’
- (d) Clause 3.1 provided that the remuneration of the Taxpayer shall be a ‘basic salary at the rate of \$240,000 per annum payable by equal monthly instalments in arrears on or about the last day of each calendar month.’
- (e) Clauses 4 and 6 conferred on the Taxpayer and his family medical and other benefits not found in Agreement 1.
- (f) Clause 16 provided that Agreement 2 ‘shall be governed by and construed in accordance with the law of Hong Kong.’.
- (g) The schedule to Agreement 2 also provided that the Taxpayer commenced his employment under this agreement on 1 December 1988.

10. The Taxpayer reported the following amounts of income to the IRD:

| <u>Period</u>        | <u>Salary</u> | <u>Severance Pay</u> | <u>Quarter</u> |
|----------------------|---------------|----------------------|----------------|
| 1-8-1984 - 31-3-1985 | \$40,000      |                      |                |
| 1-4-1985 - 31-3-1986 | \$60,000      |                      |                |
| 1-4-1986 - 31-3-1987 | \$64,000      |                      |                |
| 1-4-1987 - 31-3-1988 | \$72,000      |                      |                |
| 1-4-1988 - 31-3-1989 | \$72,000      |                      |                |
| 1-4-1989 - 31-3-1990 | \$35,640      |                      | \$390,000*     |
| 1-4-1990 - 31-3-1991 | \$186,766     |                      | \$300,000*     |

\* Amount of rent paid by Company A to the landlord.

The total amount of allowances which the Taxpayer was entitled to claim exceeded the amount of assessable income so returned. No assessment was therefore raised on the Taxpayer for the years of assessment 1984/85 to 1989/90.

11. According to the return of Company A for the year ended 31 March 1990, the Taxpayer was employed as its managing director for the period between 1 April 1989 to 31

## INLAND REVENUE BOARD OF REVIEW DECISIONS

March 1990. His 'salary/wages' for that period was \$35,640.05. This was made up by the following payments described as 'salaries' in 'cash disbursement vouchers' of Company A:

| <u>Month</u>        | <u>Amount \$</u> |
|---------------------|------------------|
| April 1989          | 1,314.5          |
| May 1989            | 1,825            |
| June 1989           | 1,612.5          |
| July 1989           | 1,527.3          |
| August 1989         | 490              |
| September 1989      | 1,739            |
| October 1989        | 2,232            |
| November 1989       | 9,608.2          |
| December 1989       | 2,711.95         |
| January 1990        | 6,572.5          |
| February 1990       | 5,000.10         |
| March 1990          | 1,007            |
| <b><u>Total</u></b> | <b>35,640.05</b> |

12. Company A closed its liaison office in Region E in 1991. The Taxpayer also resigned his employment as 'director' of Company A on 31 January 1991. According to Company A's return dated 28 February 1991, the emoluments received by the Taxpayer from 1 April 1990 to 31 January 1991 amounted to \$709,266 made up as to \$186,766 by way of 'salary/wages' and \$522,500 by way of 'severance pay.' By letter dated 27 June 1992, Company A explained to the Revenue that the sum of \$522,500 was made up as follows:

| <u>Breakdown</u>                              | <u>Amount \$</u> |
|---|------------------|
| Six months' salary under Company A's Contract | 120,000          |
| Six months' salary under Company B's Contract | 120,000          |
| Six months' accommodation allowance           | 180,000          |
| Six months' car allowance                     | 180,000          |
| Six months' Blue Cross subscription           | 5,917            |
| Eight months' pension contribution            | 26,000           |

## INLAND REVENUE BOARD OF REVIEW DECISIONS

|                     |                       |
|---------------------|-----------------------|
| Ex-gratia payment   | 52,583                |
| <b><u>Total</u></b> | <b><u>522,500</u></b> |

13. Further inquiries by the Revenue revealed:

- (a) Agreement 1 and Agreement 2.
- (b) the following amounts were allegedly paid to the Taxpayer under a Country C contract.

| <b><u>Period</u></b> | <b><u>HK\$ equivalent</u></b> |
|----------------------|-------------------------------|
| 1-8-1984-31-3-1985   | 231,777                       |
| 1-4-1985-31-3-1986   | 361,326                       |
| 1-4-1986-31-3-1987   | 387,943                       |
| 1-4-1987-31-3-1988   | 443,864                       |
| 1-4-1988-31-3-1989   | 443,817                       |
| 1-4-1989-31-3-1990   | 252,177                       |
| 1-4-1990-31-3-1991   | 704,949                       |
| <b><u>Total</u></b>  | <b>2,825,853</b>              |

14. In the light of such revelations, the Revenue sought to revise the salaries tax assessments for the years of assessment 1988/89 and 1990/91 on the Taxpayer by inclusion of the sums of \$443,817 and \$704,949 equivalent to Country C's currency of which were said by Company B to have been paid to the Taxpayer under the Country C contract. The Revenue took the view that they cannot re-open the assessments in respect of the previous years by virtue of limitation.

15. In correspondence with the Revenue, Company A indicated that

- (a) the Taxpayer discharged the following duties:
  - (i) 'The Taxpayer was director in charge of Company A which includes Company G in HK and the liaison office in Region E. His duty involved overseeing the day to day running of the HK & Region E offices. Business trips & sourcing trips to other Far East areas and frequent trips to Country C to liaise with head office and customers.' [Per letter of 31 May 1995].
  - (ii) 'The Taxpayer was involved in overall responsibility for the office in Region E. In addition, he would be expected to accompany customers and head office in Country C personnel on trips to visit

## INLAND REVENUE BOARD OF REVIEW DECISIONS

suppliers in the various Far East areas where Company G conducted business.' [*Per letter of 31 May 1995*].

- (b) the severance pay of \$522,500 was fully absorbed by Company A. [*Per letter of 20 November 1995*].
- (c) Company A did not receive any reimbursement from Company B for overseas trips of the Taxpayer. 'All his trips expenses were paid by Company A and booked as travelling expenses.' [*Per letter of 20 November 1995*].
- (d) For the year 1989-1991 the Taxpayer 'was responsible for the whole of Company A' including a quality control team under quality control manager. [*Per letter of 20 November 1995*].

16. In correspondence with the Revenue, Company B indicated that

- (a) the general nature of the Taxpayer's activities which were carried out on behalf of Company B fell into 3 broad categories [*Per letter of 24 October 1995*]:
  - (i) Product sourcing and development : This involved travelling outside of Hong Kong and visiting trade shows, factories and offices where he would work on design, amendment and creation of product for sale in Country C by Company B. Products sourced and developed included Christmas trees, Christmas decorations, artificial flowers and plants, soft toys and general giftware. This function was said to be critical to the success of the business in Country C. [*Per letter of 30 January 1996*].
  - (ii) Negotiation and conclusion of contracts : 'Following on from the sourcing and development stage, it was his responsibility (and his alone) to negotiate on behalf of Company B the best terms, prices and shipment dates possible. Again, this function was invaluable and could not be carried out from Country C.'
  - (iii) Quality control : 'he was required to be present at factories, together with members of his team, to ensure that correct production methods were being adopted by the makers, and to inspect finished production. This was to ensure that only product which had been made to out strict specification was shipped, thus preventing severe financial penalties for poor product.' 'The quality control team, under the control of [the Taxpayer] were employees of Company A at the time.'



## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (b) ‘... until the early part of 1990 his obligations to us in relation to value/importance was significantly greater than those held in regard to Company A ... Vis-a-vis Company A he had a responsibility for administrative work of a mainly routine nature.’ [*Per letter of 19 June 1995*].
- (c) ‘During the early part of 1990 [the Taxpayer’s] role changed in that he assumed responsibility for the running of Company A and consequently his responsibilities/work load there increased and as a result there was then a more even distribution of his remuneration.’ [*Per letter of 15 March 1995*].

17. According to the Taxpayer:

- (a) His employment with Company B encompassed the following duties/responsibilities:
  - (i) to take instructions from Company B;
  - (ii) to manage the liaison office in Region E for them;
  - (iii) to visit manufacturing locations;
  - (iv) to source products for them;
  - (v) to develop product for them;
  - (vi) to discuss quality in factories for them;
  - (vii) to discuss pricing for them;
  - (viii) to negotiate prices for them;
  - (ix) to conclude contracts for them;
  - (x) to look after quality during production for them;
  - (xi) to coordinate with factories for internal transport in the various countries involved [*Per letter of 28 April 1995*].
- (b) His employment with Company A encompassed the following duties/responsibilities: to look after office management of Company A business within Hong Kong [*Per letter of 28 April 1995*].

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (c) 'From my overseas travel outside of HK & Country C and the time spent on Company B's business ... the pay was in proportion but never agreed or considered a proportion of a lump sum.' [*Per letter of 28 April 1995*].

18. According to the financial statements of Company A for the period ended 31 December 1990 the following significant transactions took place between Company A and Company B:

| <b><u>Description</u></b>              | <b><u>1990 (HK\$)</u></b> | <b><u>1989 (HK\$)</u></b> |
|--|---------------------------|---------------------------|
| Sales to CIB                           | 15,565,404                | 2,862,443                 |
| Commission received from Company B     | 380,516                   | 315,877                   |
| Management fee received from Company B | 444,166                   | 637,798                   |
| Interest received from Company B       | 412,438                   | 458,555                   |

19. There is no dispute in relation to the time spent by the Taxpayer in Hong Kong during the following periods:

| <b><u>Period</u></b>            | <b><u>No of days in Hong Kong</u></b> |
|---------------------------------|---------------------------------------|
| Year ended 31 March 1989        | More than 260                         |
| Year ended 31 March 1990        | More than 223                         |
| 1 April 1990 to 31 January 1991 | 198                                   |

### **Salient points in the evidence of the Taxpayer**

20. He started living in the Far East in 1975.

21. He was interviewed in 1984 in Country C by Mr I then chairman of Company D and the managing director of Company B who wanted to employ him in two roles : 'principally at the outset to work in Hong Kong for Company A and with the prospect of working for Company B in the region.'

22. After his orientation Mr I decided that he should do some work for Company A and some for Company B. He was paid by Company A for his work in Hong Kong and by Company B for his work outside Hong Kong. Payments by Company B were initially credited into an account at a bank in Country C and subsequently into an account with another bank.

23. He had 'verbal contracts' with Company B evidenced by the amount of money he received.

24. Mr H was the managing director of Company A. Mr H was a Far East specialist and had a free hand in the running of Company A. Mr H decided what the Taxpayer was

## INLAND REVENUE BOARD OF REVIEW DECISIONS

going to be paid by Company A. Mr H viewed his role as more inter-linked with Company B. He performed fairly mundane tasks for Company A. His work involved making sure that the staff were working to their programmes for Company A. He would sometimes interview new staff if they were required.

25. By way of example as to the services he rendered to Company B : he would go into Company J, a department store's head office in Country C and take a brief on their requirements. His experience enabled him to identify the appropriate and best factory for the product. He would physically visit the factories for a couple of days. He would report back to Company B. Orders were placed by Company J on Company B and Company B would make payments to the factories.

26. Assessments were effected monthly. Company B would assess on the basis of the amount of business that Company B was doing and the value of his work to them. The managing director of Company A 'would normally direct Company B's managing director as to how I would be remunerated for the work that I did.'

27. Company A did not take up the cost of his travelling in the region. Company B sent on a monthly basis a lump sum to Company A as management fee charge.

28. Agreement 1 and Agreement 2 were prepared because of the appointment of a Mr K to the board of Company B with responsibility for the overseas businesses of Company D. Mr K was very methodical and well organised and tried to standardise arrangements for employment. He could give no assistance on the terms of Arthur Young's advice of 27 January 1989 as the letter was not addressed to him.

29. Save for the new title as managing director of Company A's M & S division, the terms of the 2 agreements were reflective of the pre-11 May 1989 position.

30. After conclusion of Agreement 1 and Agreement 2 he received in total the amounts under the two agreements but 'the splits were not according to the contracts.' The two agreements introduced 'an arrangement that Company D wanted to standardise, but ... in reality it was not carried through.' '... I was paid for the work that I did for Company A in Hong Kong and I was paid by Company B for the work I did for Company B, so I didn't lose out. The total amount roughly came to the same amount.' He did not quantify the sums to be paid by Company B and by Company A. 'It was quantified for me for the work that I did.' He received some but not all the benefits under the agreements. 'Again the company was very much of the opinion that if you nit-picked too much ... then you were just being a bit of a trouble-maker.'

31. He had to be based in the Far East and he reckoned that 'Hong Kong is as good, or better, than anywhere else.' He did some work for Company B whilst he was in Hong Kong.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

32. In respect of the period between 1 April 1990 to 31 January 1991, Mr H left under a cloud and he was asked to spend more time trying to cover some of the things he left behind. He was therefore paid more by Company A than the previous periods.

33. He disagreed with the 'organisational chart' set out in Company A's letter of 20 November 1993 showing him to be the officer 'responsible for the whole company' in the years 1989 – 1991.

34. He disagreed with Company A's letter of 20 November 1995 in stating that the severance pay of \$522,500 was fully absorbed by Company A.

### **Onus of proof**

35. The Taxpayer does not dispute that, by virtue of section 68(4) of the Inland Revenue Ordinance ['the IRO'], the onus is on him to prove that the assessment appealed against is excessive or incorrect. For this purpose the Taxpayer must substantiate his case by credible evidence.

36. We view the evidence of the Taxpayer with reservations. A cardinal feature of this case is the complete contrast in the role of the Taxpayer as painted by correspondence between the Revenue and Company A on the one hand and with Company B/the Taxpayer on the other. Apart from the bare denials by the Taxpayer, no attempt was made to call any one from Company A to explain the discrepancies. The burden on the Taxpayer under section 68(4) is not a heavy one but efforts must be made to discharge the same.

### **One contract of employment or two?**

37. Evidence of the position before 11 May 1989 is sketchy. The Taxpayer's case depends to a considerable extent on his oral evidence and the statements made by Company B in the course of the Revenue's investigation. The Revenue countered by paying reliance on the letter of Arthur Young dated 27 January 1989. The essence of that letter was the recommendation of a new regime comprising of 'the Hong Kong contract' and 'the non-Hong Kong contract.' The letter is inconsistent with the evidence of the Taxpayer that Mr K was merely attempting to standardise pre-existing arrangement. The schedule annexed to Agreement 1 is also of significance. Company A was identified as the 'previous employer' of the Taxpayer and his employment with Company A was said to commence on 31 May 1984. The Taxpayer and Company B gave no explanation for the information embodied in this schedule. This schedule lends weight to the view that there was only one contract of employment before 11 May 1989. That was a contract between the Taxpayer and Company A on terms of the letter dated 22 May 1984. The Taxpayer's salary 'package' was duly increased from \$25,000 to \$30,000 upon completion of his trial period. The payments to the Taxpayer in Country C were made in discharge of Company A's obligations under this sole contract.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

38. The Revenue attacked Agreement 1 and Agreement 2 to displace any suggestion that there were two contracts of employment after 11 May 1989. No attempt was made to invoke the anti-avoidance provisions in sections 61 or 61A of the IRO. The attack was mounted on the basis of the principles in Ramsay v IRC [1981] STC 174 as explained by IRC v McGuckian [1997] STC 908. Mr Thomson for the Taxpayer sought to confine the principles in Ramsay to self-cancelling transactions and to arrangements where the parties were contractually bound to take each step in a series of transactions. This is inconsistent with the views of Lord Brightman in Furniss v Dawson [1984] 2 WLR 226 at page 242. However in D52/86, IRBRD, vol 2, 314 another Board took the view that the Hong Kong situation was comparable to that in Australia and the reasoning in Patcorp Investments Ltd v FTC 76 ATC 4225 should be adopted to reject the notion that the doctrine established in Ramsay has any application to Hong Kong income tax avoidance cases. The majority of the Law Lords in IRC v McGuckian also stressed that the Ramsay line of cases is ultimately concerned with statutory interpretation. Given the stance of the Taxpayer vis-a-vis the two 11 May 1989 agreements, we are not disposed to reach a concluded view on the applicability of the Ramsay line of authorities.

39. The Taxpayer also disowned the Agreement 1 and Agreement 2 as his entitlements under the two agreements are inconsistent with his case of actual receipts after 11 May 1989. The Taxpayer said this:

‘They introduced an arrangement that Company D wanted to standardise, but it actually in reality it was not carried through.’

40. In this connection, we derive assistance from the following statements of Macdougall J in CIR v Goepfert 2 HKTC 210 at page 237

*‘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 connection. He is entitled to scrutinise all evidence, documentary or otherwise, that is relevant to this matter.’*

We appreciate that this statement of principle was said in the context of ascertaining the source of income. We are, however, of the view that this gives general guidance to the Board in arriving at findings of fact.

41. We are of the view that the following factors indicate that in reality there was only one contract of employment between the Taxpayer and Company A after 11 May 1989.

- (a) The Taxpayer’s case centres around the subsistence of the two 11 May 1989 agreements. As pointed out above, the Taxpayer for his own purpose admitted that the two agreements were in reality not carried through.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (b) The Taxpayer's evidence on the alleged manner whereby his salaries were apportioned between the two alleged contracts is vague and unsatisfactory. He admitted that he kept no time sheet. There is force in the Revenue's contention that there was no rational basis for the apportionment between the two contracts save to ensure that there was no admission of income in Hong Kong more than the allowances that he was entitled under the IRO.
- (c) The letter from Company A dated 31 May 1995 contained a very full account of the position and duties of the Taxpayer as the director in charge of Company A. The Taxpayer sought to refute this account but no attempt was made to call the author of this letter to explain the alleged inaccuracies. This letter is inconsistent with the claims of Company B that various tasks which were part and parcel of the Taxpayer's duties as Company A's director were performed by him on behalf of Company B.
- (d) The Taxpayer admitted in cross examination that for the period after 11 May 1989, Company A sold merchandise to Company B and Company B sold to Company J. This lends weight to the view that various tasks were performed by the Taxpayer for Company A and not for Company B.
- (e) The audited accounts of Company B reinforced the Revenue's contentions. Sales by Company A to Company B amounted to \$2,800,000 in 1989 and \$15,500,000 in 1990. Company B paid Company A sizeable commission and management fee. The Taxpayer's evidence shed no light on the basis whereby commission was earned by Company A. Given the description in Company A's audited accounts, we find it difficult to accept the Taxpayer's explanation that the management fee was Company B's attempt to reimburse Company A in respect of his cost of travelling in the region.
- (f) Company A said in its letter of 20 November 1995 that the entire sum of \$522,500 paid as severance pay in favour of the Taxpayer was absorbed by Company A. We see no reason why Company A should misrepresent the position. In any event, Company A was not called to explain the error.

For these reasons, we are of the view that for the period after 11 May 1989, there was only one contract of employment and that was between the Taxpayer and Company A.

### **If one contract of employment, was it sourced in Hong Kong or the UK?**

42. The principles outlined in *CIR v Goepfert* (above cited) are well known. The expression 'income arising in or derived from Hong Kong' in section 8(1) of the IRO is referable to the locality of the source of income and not the place where the duties of the

## INLAND REVENUE BOARD OF REVIEW DECISIONS

employee are performed. The place where the services are rendered is not relevant to the enquiry under section 8(1) as to whether income arises in or is derived from Hong Kong from any employment and should be completely ignored.

43. We are of the view that the one contract of employment that we find was sourced in Hong Kong:

- (a) The contract of employment was a continuation of the arrangement as embodied in the letter of 22 May 1984 addressed to the Taxpayer in Hong Kong. The writer of that letter pointed out that the position would be reviewed during his visit to the Far East in October 1984.
- (b) Company A was the employer. It is a company incorporated in Hong Kong. The Taxpayer accepted in cross examination that he was based in Hong Kong.
- (c) The Taxpayer's remuneration was paid to him partly in Hong Kong and partly outside Hong Kong.
- (d) The Taxpayer was responsible for the whole of Company A. All his trip expenses were paid by Company A and booked as travelling expenses. Company A also provided him with accommodation in Hong Kong.

### **If we be wrong and there were two contracts of employment**

44. On the assumption that there were two contracts of employment and Agreement 1 was sourced outside Hong Kong, we agree with the Commissioner that the position falls to be considered under section 8(1A)(a) of the IRO. The Taxpayer admitted in cross examination that he did some work for Company A whilst he was in Hong Kong. 'I just could not quantify that in the actual work that I was employed to do with Company B was in factories outside Hong Kong.'

45. We have explained above our rejection of the contention that work was done for Company B as opposed to Company A outside Hong Kong.

46. The onus is on the Taxpayer to demonstrate that the assessment is incorrect as the same exceeded the income that he derived from services rendered in Hong Kong. The Taxpayer made no attempt to discharge this onus.

### **Our decision**

47. For these reasons, we dismiss the Taxpayer's appeal and confirm the assessment.