Case No. D40/90

Salaries tax – claim to apportion income on 'days in – days out' basis – section 8 of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Raphael Chan Cheuk Yuen and Wilfred Lee Chee Wah.

Date of hearing: 16 August 1990.
Date of decision: 29 October 1990.

The taxpayer was employed by a company incorporated and carried on business in Hong Kong which was a subsidiary of a multi-national group of companies with its head office in USA. The taxpayer was employed as a regional internal auditor to perform internal audit assignments throughout the Asia/Pacific region. The taxpayer submitted that he was in reality employed by the parent company in USA and not by the company in Hong Kong.

Held:

Applying the Goepfert decision the real source of the income of the taxpayer was Hong Kong.

Appeal dismissed.

Cases referred to:

CIR v George Andrew Goepfert 2 HKTC 210
Bennet v Marshall [1938] 1 KB 591
Pickles v Foulsham [1925] AC 458
Bray v Colenbrander [1953] AC 503
BR 20/69, IRBRD, vol 1, 3
Edwards v Bairstow [1955] 3 WLR 410

Lee Kang Bor for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

This is an appeal by a taxpayer against salaries tax assessments for the years of assessment 1985/86, 1986/87 and 1987/88. The Taxpayer claims that his income should have been apportioned between the number of days he spent within and outside of Hong Kong. The facts are as follows:

1. His employer was a company incorporated and carrying on business in Hong Kong which was a subsidiary of a multi-national group of companies with its head office in USA. The employer placed advertisements in Hong Kong newspapers in January and February 1985 in order to recruit a 'regional internal auditor'. The primary job function was described as 'to perform internal auditor assignments of marketing and manufacturing subsidiaries throughout the Asia/Pacific region.'

2. The Taxpayer who was living in Hong Kong answered the advertisement in Hong Kong and on 11 March 1985 accepted terms of employment offered to him by the employer in Hong Kong.

3. The salary of the Taxpayer was designated in Hong Kong dollars and was paid to the Taxpayer by the employer in Hong Kong.

4. The duties of the Taxpayer were to conduct or assist in conducting internal audits of group companies in the Asia/Pacific region and a significant part of his time was spent in performing these services outside of Hong Kong. He accepted instructions from and reported to the group internal audit department which was situated in USA.

5. The employer in Hong Kong was reimbursed the cost incurred by the employer in relation to the Taxpayer relating to the services which the Taxpayer performed outside of Hong Kong. The Taxpayer also performed group internal audits inside Hong Kong but there is no evidence as to whether or not the expenses in relation to such work performed by the Taxpayer were recovered by the employer.

6. The assessor assessed the Taxpayer on the total amount of his income from his employment. The Taxpayer objected to the three assessments for the three years in question and submitted that his income should be apportioned on the basis of the time he spent in Hong Kong and the time which he spent overseas.

7. By his determination dated 15 March 1990, the Deputy Commissioner of Inland Revenue issued his determination in which he upheld the three assessments against which the Taxpayer appealed and the Taxpayer proceeded to give due notice of appeal to his Board.

At the hearing of the appeal, the Taxpayer appeared in person and submitted that he was in reality employed as regional internal auditor by the parent company in USA and not by the employer which is a Hong Kong company carrying on business in Hong Kong. He said that for administrative and logistics reasons, some internal auditors of the American company are stationed in Hong Kong and are 'hosted' by the employer. He said that throughout his employment, he had no reporting relationship to the employer in Hong Kong. He said that his regional responsibility covered many territories outside of Hong Kong and the entire operating cost was funded by the US company. He said that he was required to perform internal audit work in regions which were outside of the regions controlled by the employer in Hong Kong. He stressed that all of his duties as internal auditor were not under the jurisdiction of the employer and that his terms of employment were in line with the head office terms of employment in USA. He said that the employer in Hong Kong did not dictate the manner in which he carried out his duties and if there were any complaints regarding his work, they would be handled by the head office in USA and not the employer which was a subsidiary in Hong Kong. He went on to set out at some length the many ways in which he considered himself to be different from other employees of the employer in Hong Kong. We do not consider it necessary for us to set this out either in the facts which we have found nor in the submission which he made. We accept that the Taxpayer was on different employment terms to other employees of the employer and that he performed different duties.

Though the Taxpayer agreed that his remuneration was paid to him in Hong Kong, he submitted that it neither arose in nor was derived from a source in Hong Kong because it was paid by the employer in Hong Kong for and on behalf of the parent company in USA. He pointed out that within the group reporting and accounting procedures, he was not considered to be part of the 'headcount' of the employer and likewise the employer did not include his salary in the internal financial statements which it reported within the group.

The representative for the Commissioner submitted that the Taxpayer was employed by the employer in Hong Kong and that accordingly his income was taxable in Hong Kong. He said that the source of income is where the employment is located. The representative pointed out that if the source of income was located in Hong Kong, then the entire salary was taxable in Hong Kong and there was no question of appointment.

In the course of the hearing we were referred to the following cases:

CIR v George Andrew Goepfert 2 HKTC 210

Bennet v Marshall [1938] 1 KB 591

Pickles v Foulsham [1925] AC 458

Bray v Colenbrander [1953] AC 503

This is an important case, because it is one of the first cases to come before the Board of Review following the decision of MacDougall J in the Goepfert case. That case has been widely reported and has formed the basis of guidelines which have been issued by the Commissioner and accepted by many professional advisers. The representative for the Commissioner informed us that the Commissioner accepted that following the Goepfert decision, an employment is located outside Hong Kong where the following three factors are present, namely:

A. The contract of employment was negotiated and entered into, and is enforceable outside Hong Kong.

B. The employer is resident outside Hong Kong; and

C. The employee's remuneration is paid to him outside Hong Kong.

The representative went on to say that the Revenue may look beyond these three factors in appropriate cases and cited the following words from page 237 of the Goepfert decision:

> '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.'

In deciding this case, we first refer to the Goepfert decision. After analysing the submissions made before him and the cases cited to him, MacDougall J delivered his judgment in the following terms:

> 'As a matter of statutory interpretation I am unable to escape the conclusion that, although section 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.
>
> 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 is derived from Hong Kong from any employment. It should therefore be completely ignored.
>
> That being so, what is the correct approach to the enquiry? The approach that commends itself to me, and which I take to be

correct, is that adopted by the English courts in the cases cited by Mr Flesch.

In my view this is an approach that is entirely consistent with a correct interpretation of section 8, for although at first sight it might seem somewhat illogical to ignore the place where the services are rendered, it seems to me that to do so is consistent with an acceptance that section 8(1A)(a) is an extension of the basic charge imposed under section 8(1).

In this connexion the Commissioner's own departmental practice is illuminating. Appendix 10 of the Inland Revenue Departmental Interpretation and Practice Note relating to the charge to salaries tax states:

> "If the income from employment does not come within the basic charge, because it does not 'arises in' or 'derive from' a source in the Colony, then consideration will need to be given as to whether liability arises under the extension to the basic charge by the provisions of section 8(1A). Sub-section (a) of section 8(1A) does not in any way limit the charge in section 8(1); it extends the charge by specifically including as income arising in or derived from the Colony, all income derived from services rendered in the Colony including leave pay attributable to such services. It should be noted that this sub-section relates only to employment; it does not apply to offices of profit."

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 scrutinise all evidence, documentary or otherwise, that is relevant to this matter.

If any authority be needed for this basic proposition one needs only to refer to the worlds of Lord Normand at page 155 of Bray v Colenbrander:

> "My Lords, in each of these appeals the respondent entered into a contract of employment with an employer resident

> abroad. The contract was in each case entered into in the country of the employer's residence and it provided for payment of the employee's remuneration in that country. Parenthetically it should be said that there is not suggestion that the place of payment was nominal or pretended, or that the real or genuine place of payment was not the place specified in the contract. Nothing, therefore of what follows in this opinion in any way touches a case where the designated place of payment is challenged as nominal or pretended and unreal."

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. If that is what it means then it is not an enquiry of a nature different from that to which the English cases refer, but is descriptive of the process adopted to ascertain the true answer to the question that arises under section 8(1).

It is plain that, without specifically referring to the English cases, the Board of Review in BR 20/69 applied the correct test in dismissing the appeal of a taxpayer. Had the converse factual situation existed, that is to say, had the taxpayer been employed by an overseas company who paid for the services rendered by the taxpayer in Hong Kong from money originating overseas, the Board, in applying the reasoning they employed in that case, would have been obliged to decide that the taxpayer's income was not liable to salaries tax under section 8(1). It is not surprising therefore that section 8 (1A)(a) was enacted so as to operate as an extension to the basic charge under section 8(1).

After its enactment, the cases show that there was no consistency of approach adopted by variously constituted Boards of Review. It seems probable that the totality of facts test has been interpreted differently by different Boards. It is only when that so-called test embraces the place where the services were rendered or otherwise introduces irrelevant matters that it becomes impermissible.

Having stated what I consider to be the proper test to be applied in determining for the purpose of section 8(1) whether income arises

in or is derived from Hong Kong from employment, the position may, in my view, be summarised as follows.

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.

I hasten to add, however, that the "60 days rule" does not apply to the income derived from services rendered by those persons who, by the operation of section 8(1A)(b)(i) are excluded from enjoying the benefit conferred by section 8(1A)(b)(ii) as read with section 8(1B).

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".

Thus the respondent, who in the light of the Board's findings does not fall within the basic charge imposed under section 8(1), is only liable to pay salaries tax on the whole of the income derived from the services he actually rendered in Hong Kong. Since he rendered services outside Hong Kong for 41 days he is not liable to salaries tax in respect of income attributable to those services. In other worlds his income for salaries tax purposes is apportioned on a "time in time out" basis.

Had the respondent merely earned income from services rendered in Hong Kong during visits not exceeding a total of 60 days in the year of assessment, then by virtue of section 8(1A)(b)(ii) read with section 8(1B)(the "60 days rule"), that income would be exempted from liability to salaries tax.

There is no suggestion that the decision of the Board is open to challenge under the principle stated in Edwards v Bairstow, namely, that no person acting judicially and properly instructed as to the relevant law could have come to that decision. On the relevant evidence accepted by the Board, the respondent was bound to succeed.'

We have quoted at length from the decision of MacDougall J because we find it to be a most useful summary of the law in the light of the United Kingdom cases and previous Board of Review decisions. We have not cited earlier parts of the judgment of MacDougall J but we find his careful analysis of the many earlier Board of Review decisions to be most useful and information.

What the learned Judge has said in his decision is that Boards of Review must look at all of the relevant facts. The Board must then ignore the place where the services are rendered and decide for the purposes of section 8(1) of the Inland Revenue Ordinance what is the true source of the income, namely where 'the employment', is located.

There are only two statements in the judgment of MacDougall J with which we find difficulty. The first is the following paragraph:

> 'After its enactment, the cases show that there was no consistency of approach adopted by variously constituted Boards of Review. It seems probable that the totality of facts test has been interpreted differently by different Boards. It is only when that so-called test embraces the place where the services were rendered or otherwise introduce a relevant matter that it becomes impermissible.'

We are not quite sure what is the meaning of this paragraph. It would appear to be a repetition of the often voiced criticism of previous Board of Review decisions that they are inconsistent with each other. Whilst this criticism has often been made in the past, rarely has anyone, including MacDougall J sought to justify the criticism by explaining the nature of the inconsistencies. It appears to us that the consistency required is for each Board to review all of the relevant facts but to disregard the place where the services were rendered. We presume that what MacDougall J meant was that any decisions of Boards who have taken into account the place where services were rendered as part of the totality of facts test are inconsistent and incorrect. If this is the meaning then we understand and agree with the logic. If, however, the inconsistency is that one Board has decided one way and another Board has decided another way on what appear to be similar facts, then we find it difficult to agree. The point is that no two cases have identical facts. When facts are set out on a piece of paper, they lose the flavour, colour and nuances which are apparent to the Board which was hearing the case. This is the reason why under the Edwards v Bairstow principle decisions of fact by a Board of Review cannot be challenged. It is also why it is dangerous to try to use one previous decision based on fact to determine a subsequent case with similar but not necessarily identical facts.

The second statement of MacDougall J which gives us difficulty is as follows:

> 'Having stated what I consider to be the proper test to be applied in determining for the purpose of section 8(1) whether income arises in or is derived from

Hong Kong from employment, the position may, in my view, be summarised as follows.'

The problem which we have is reference to 'the proper test to be applied'. It appears to us that the test which MacDougall J has promulgated is simply that he Board must look at all of the relevant facts save and except the place where the services were rendered. He calls this 'the totality of facts' test. We find it a little strange to call this a test. What is being said is no more than the guiding principle in all source cases. All source cases must be decided as a practical hard matter of act looking at all relevant facts. Source of income is not a legal concept.

We have referred to this second point because of the policy adopted by the Commissioner following the Goepfert case. Apparently, the Commissioner has promulgated three tests to be studied when deciding if employment is located outside of Hong Kong. We can find no direct justification for what the Commissioner has promulgated following the Goepfert decision. Indeed by saying that if a taxpayer complies with three tests, he is not taxable in Hong Kong it would seem to us to be contrary to 'the totality of facts test' set out by MacDougall J. It surely must be wrong to look at three facts only. If we accept the Commissioner's test, then a degree of artificiality would enter into our taxation system. Employees with the assistance of their tax advisers would in future negotiate and enter into employment contracts outside of Hong Kong with companies outside of Hong Kong and with remuneration paid into a bank account outside of Hong Kong. In such circumstances the employee will then submit that he is not within section 8(1) of the Inland Revenue Ordinance because he has complied with the Commissioner's guidelines.

In the present case, the approach which we take is to look at the employment of the Taxpayer in the light of section 8(1) and in the light of the early decision of the Board of Review in BR 20/69. MacDougall J has considered and approved this decision at some length in his judgment. In our opinion, BR 20/69 is of great importance because it was decided on section 8(1), before the introduction of section 8(1A). Indeed it was as a result of that Board decision that the law was amended. In BR 20/69, an employee was employed in Hong Kong by a Hong Kong company and in the course of his employment he was posted to Japan where he rendered his services for the benefit of his Hong Kong employer. The Board held in that case that the employee was taxable because his remuneration arose from his 'employment' which was Hong Kong. Following that Board decision, the law was amended to provide that if an employee under a Hong Kong employment were to perform all of his services overseas, he would not be subject to tax in Hong Kong. In determining whether he performed all of his services overseas, period of less than 60 days in Hong Kong are to be disregarded.

There is much similarity between the facts of the present case and BR 20/69. However, as we have mentioned above it is unwise to compare the facts of one case too closely with the facts of another. No two sets of facts are ever identical. However, the

principles of BR 20/69 are clear and they were clearly approved by MacDougall J in the Goepfert decision.

Applying those principles to the present case, we have no hesitation in finding that the source of income, namely the employment, of the Taxpayer in this case was Hong Kong. He was employed in Hong Kong by a Hong Kong employer after answering an advertisement in the Hong Kong press. We find no substance in the submission of the Taxpayer that he was either legally or in effect employed by the parent company or another group company outside of Hong Kong. It is quite clear from the employment contract of the Taxpayer that he was employed by the employer in Hong Kong and that the employer is a Hong Kong company. In this case there is no element of artificiality in the contract of employment which is clearly a Hong Kong contract of employment.

We accept the submission by the Taxpayer that his terms of employment and the manner in which he performed his services were substantially different from other employees of the employer in Hong Kong. We accept that he was required to travel extensively outside of Hong Kong and perform services outside of Hong Kong. We likewise accept that for operational purposes the Taxpayer reported to senior staff in USA in the course of performing his services as internal auditor.

However, none of the foregoing affects the real source of his income or the place of his employment. In so far as he was performing services overseas, we are to disregard such facts (the Goepfert decision). To whom he reported within the multi-national group of companies does not affect the nature or place of his employment. He was as a matter of fact employed by a company in Hong Kong. If those to whom he reported in practice wished to terminate his services, they could only do so through his employer in Hong Kong. We cannot ignore the true facts and interpose facts which the Taxpayer would like us to accept because they may give him a more favourable tax result. We do not express any opinion as to whether or not the Taxpayer would have been successful in his appeal had he been employed by an American company outside of Hong Kong and had he in fact been paid by such a company outside of Hong Kong. It is not necessary for us to express any opinion in this regard.

On the facts before us, we find that the source of the Taxpayer's income for the purposes of section 8(1) of the Inland Revenue Ordinance was Hong Kong and accordingly all of his income is subject to Hong Kong tax.

For the reasons given, the appeal is dismissed.