

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D53/96

Salaries tax – offshore employment – whether taxpayer rendered part of his services in Hong Kong – if so, how his income should be apportioned.

Panel: Robert Wei Wen Nam QC (chairman), Philip Fu Yuen Ko and E M I Packwood.

Dates of hearing: 9 and 17 April 1996.

Date of decision: 14 October 1996.

The taxpayer was employed by a company incorporated outside Hong Kong as Regional Sales Manager based in Hong Kong. He rendered his services in Hong Kong as well as outside Hong Kong.

Held:

The taxpayer derived his income from services rendered in Hong Kong as well as outside Hong Kong. His income should be apportioned on the ‘time in time out’ basis.

Appeal dismissed.

Case referred to:

CIR v Goepfert 2 HKTC 210

H Bale for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

Introduction

1. This is an appeal by an individual (the Taxpayer) against the salaries tax assessments raised on him for the years of assessment 1990/91 and 1991/92, as revised by the Commissioner of Inland Revenue in his determination dated 22 September 1995, on the ground that all of the income in question was derived from an offshore employment with a Country A employer (the Country A company).

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2. The Commissioner agrees through his representative Mr Bale that the Taxpayer's employment with the Country A company was not a Hong Kong employment. However, he contends that the Taxpayer rendered services in Hong Kong as well as outside Hong Kong, and therefore that, by reason of section 8(1A)(a), the Taxpayer's income is chargeable to salaries tax to the extent that it was derived from services rendered in Hong Kong. The issues for this appeal are therefore: (1) whether the Taxpayer rendered part of his services in Hong Kong, and, if so, (2) how his income should be apportioned for taxation purposes.

Historical background

3. On divers dates, the assessor raised on the Taxpayer the following salaries tax assessments for the years of assessment 1990/91 and 1991/92:

Year of Assessment 1990/91

Assessable Income	<u>\$1,409,695</u>
Tax Payable thereon	\$211,454 =====

Year of Assessment 1991/92

Assessable Income	<u>\$1,159,846</u>
Tax Payable thereon	\$173,976 =====

4. The Taxpayer objected against the assessments on the following grounds:
- The Taxpayer's employer was the Country A company, an overseas company resident in Country A.
 - The Taxpayer's contract of employment was negotiated, concluded and was enforceable outside Hong Kong.
 - All of the commission was derived from overseas. The Taxpayer travelled outside Hong Kong to negotiate and conclude sales and no sale was concluded in Hong Kong. Hence, all of the commission income should be exempted from salaries tax.
5. In his salaries tax returns for the years of assessment 1990/91 and 1991/92 the Taxpayer declared, inter alia, the following income particulars:

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	1990/91 \$	1991/92 \$
(a) Salary	251,329	Nil (offshore)
(b) Leave pay		Nil (offshore)
(c) Commission		Nil (offshore)
(d) Education (children)	37,696	78,105
(e) Overseas allowance	<u>198,969</u>	<u>262,754</u>
	\$487,994 =====	\$340,859 =====

The income of \$487,994 for the year of assessment 1990/91 was calculated on the following time apportionment basis:

number of days spent in Hong Kong/365 x (salary, education benefits and overseas allowances)

$$196/365 \times (\$468,037 + \$70,200 + \$370,529)$$

6. By letter dated 23 December 1993, the assessor, having accepted that the Taxpayer's employment was located outside Hong Kong and that the Taxpayer's income was chargeable to salaries tax in terms of section 8(1A)(a) of the Inland Revenue Ordinance (the IRO) to the extent that it was derived from services rendered in Hong Kong, proposed to the Taxpayer to revise the assessments in the following manner:

Year of Assessment 1990/91

Income	\$1,409,695
Number of days outside Hong Kong	152
Number of days in the basis period for the year of assessment 1990/91 from 1-4-1990 to 31-3-1991	365
Income attributable to services in Hong Kong	\$822,643
$\$1,409,695 \times \frac{365-152}{365}$	

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Tax payable thereon	\$123,396
	=====

Year of Assessment 1991/92

Income	\$1,159,846
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Number of days outside Hong Kong	37
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Number of days in the basis period for the year of assessment 1991/92 from 1-4-1991 to 21-1-1992	296
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Income attributable to services in Hong Kong

$\$1,159,846 \times \frac{296-37}{296}$	\$1,014,865
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Tax payable thereon	\$152,229
	=====

The Taxpayer did not accept the assessor's proposal.

7. The Taxpayer's tax representatives (the Representatives) claimed that the income reported by the Taxpayer in his salaries tax returns for the years of assessment 1990/91 and 1991/92 was a concession only and that the Taxpayer had decided to withdraw the concession, and to contend instead that the whole of his income was not taxable on the following grounds:

- (a) the employment contract with the employer the Country A company was negotiated, concluded and enforceable outside Hong Kong.
- (b) the employer was resident outside Hong Kong.
- (c) services rendered by the Taxpayer were mostly outside Hong Kong.
- (d) Hong Kong office was used as place of convenience with 'no back up in technical or negligible administrative back up'.

8. By his determination dated 22 September 1995, the Commissioner decided against the Taxpayer's objection and revised the assessments as shown in paragraph 6 above.

Grounds of appeal

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9. The principal grounds of appeal are as follows:

9.1 The employment contract dated 6 October 1989 was entered into between an overseas employer and the Taxpayer.

9.2 The overseas employer is resident outside Hong Kong.

9.3 The employment contract was negotiated, concluded and enforceable outside Hong Kong.

9.4 The commission earned by the Taxpayer was derived from contracts concluded in places other than Hong Kong.

The relevant law

10. The following provisions of section 8 of the IRO are relevant to this case:

'8(1) Salaries tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from the following sources-

(a) any office or employment of profit...

(1A) For the purposes of this Part, income arising in or derived from Hong Kong from any employment-

(a) includes, without in any way limiting the meaning of the expression and subject to paragraph (b), all income derived from services rendered in Hong Kong including leave pay attributable to such services;

(b) excludes income derived from services rendered by a person who-

(i) is not employed by the Government or as master or member of the crew of a ship or as commander or member of the crew of an aircraft; and

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

(1B) In determining whether or not all services are rendered outside Hong Kong for the purposes of subsection (1A) no account shall be taken of services rendered in Hong Kong during visits not

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exceeding a total of 60 days in the basis period for the year of assessment.'

10.1 If a person derives income from an overseas employment, his income does not fall within the basic charge to salaries tax under section 8(1). But if in respect of the overseas employment he renders services in Hong Kong, that part of the income which is derived from the services rendered in Hong Kong is chargeable to salaries tax under section 8(1A)(a), subject only to relief by way of exemption under section 8(1A)(b) as read with section 8(1B).

Persons appearing at the hearing

11. At the hearing of this appeal, the Taxpayer appeared in person, while the Commissioner was represented by his representative Mr Bale. The Taxpayer gave evidence for himself. No other witness was called.

Agreed facts

12. The following facts are agreed or not in dispute.

12.1 The Country A company was a company incorporated in Country A and was a member of a group of companies with headquarters in Country B (the Country B group).

12.2 By letter dated 6 October 1989, the Taxpayer was offered an employment with the Country A company as Regional Sales Manager II based in Hong Kong.

12.3 The offer letter provided for a remuneration package which included the following:

- | | | |
|-----|--------------------|---|
| (a) | Salary | US\$60,000 per annum |
| (b) | Commission | Participation in a sales commission plan where annual on target commission would be at US\$33,000 |
| (c) | Sign on fee | US\$6,000 after 30 days employment subject to recovery if left employment within one year |
| (d) | Overseas allowance | US\$47,500 per annum payable monthly |

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- (e) Reimbursement of children's education expenses up to US\$7,000 per annum

12.4 The Taxpayer accepted the offer. His employment with the Country A company commenced on 15 November 1989 when he commenced to work in Hong Kong. The employment was terminated on 21 January 1992.

12.5 Particulars of the Taxpayer's designation and income for the years of assessment 1990/91 and 1991/92 are as follows:

	1990/91	1991/92
(a) Capacity in which employed	Regional Director	Regional Sales Director
(b) Period of employment	1-4-1990 to 31-3-1991	1-4-1991 to 21-1-1992
(c) Income Salary	\$468,037	\$390,150
Leave pay		32,514
Commission	500,929	257,013
Education benefits	70,200	78,105
Overseas allowance	370,529	308,868
Severance pay	_____	_____93,196
	\$1,409,695 =====	\$1,159,846 =====

12.6 During the year ended 31 March 1991 (1990/91) the Taxpayer spent 213 days in Hong Kong and 152 days outside Hong Kong. During the period ended 21 January 1992 (1991/92) the Taxpayer spent 259 days in Hong Kong and 37 days outside Hong Kong.

12.7 The Taxpayer set up an office in District C, Hong Kong in February 1990 and used it until mid-January 1991. From then onwards the Taxpayer used an office of a Hong Kong company which was also a member of the Country B group in District D, Hong Kong.

Evaluation and findings

13. The Taxpayer was employed to generate sales in the Asia-Pacific Region of the Country B group's products such as data communication systems, equipment, networks, etc. At all times his employer was the Country A company. Administratively, however, directions regarding his work came from a group company in Country B (the Country B

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company); all communications from the Taxpayer were addressed to the Country B company.

14. In their letter of 11 August 1994, the Taxpayer's tax representatives provided the Commissioner of Inland Revenue with, inter alia, the following information regarding the Taxpayer's duties which we accept:

'The duty of the [Taxpayer] is:

- (a) primarily identifying markets and implementing planned sales activities in Asia. The areas covered are:

For the year 1 January 1990 to 31 December 1990: Country E, Country F, Hong Kong, Country G, Country H, Country I, Country J, Country K.

For the year 1 January 1991 to 31 December 1991: Country J, Country H and Country K.

- (b) maintaining good business relationship with respective Post Telephone and Telegraph Authority.
- (c) managing sales activities in the Region.
- (d) Achieve sales quota.
- (e) set up regional sales office and establish sales/support team in Hong Kong.

Although [the Taxpayer] had set up the regional team in Hong Kong by end 1990, his regional job from 1 January 1991 excluded Hong Kong altogether.'

15. The Taxpayer was paid a commission on sales contracts concluded. The amount varied from contract to contract, as it was calculated at a percentage on the sales volume. His salary, allowances and other income were in fixed sums.

16. The Taxpayer concluded no sales contract in respect of Hong Kong.

17. The enquiry before the Board was whether the Taxpayer derived income from services rendered in Hong Kong; it centred on the question of whether he derived his commission income from services rendered in Hong Kong. The Taxpayer produced a document prepared by himself and setting out 'Normal sales procedure leading to conclusion of a contract' (the 'Normal Procedure'). It consisted of the following steps:

'Normal sales procedure leading to conclusion of a contract

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- (1) Approach prospects in the different cities to find out their technical and business requirements.
- (2) Communicate the requirements of the prospects to headquarters from the hotels right after the meetings.
- (3) Headquarters proposal team works out network/technical proposals with price quotations and sends directly to prospect.
- (4) Follow-up visits to prospects and customers to discuss technical proposals, prices and terms.
- (5) Negotiate sales contract terms, communicate the likely acceptable terms to headquarters for approval and headquarters to prepare draft sales contracts.
- (6) Headquarters superior, accompanied by company lawyer and myself to visit customers to finalise and sign sales contracts at the customers' offices.
- (7) All contracts and sales transactions were between the headquarters and the customers in the different cities. All products, equipment, software and hardware were shipped directly from Country B to the customer. No business went through the Hong Kong office.'

We accept the 7 steps as representing the activities carried out outside Hong Kong, subject to what we say below as to what happened in Hong Kong.

18. To illustrate the 7 steps, the Taxpayer cited as a typical example the last sales contract he closed during his employment, a contract for a project in Country K which the telecom company of Country J (Company L) was negotiating on behalf of the principal in Country K. The Taxpayer produced a 'Travel Schedule' for the years ended 31 March 1991 and 1992 prepared by himself. It is as follows:

Travel Schedule for year ended 31 March 1991

Date Out of Hong Kong	Date in Hong Kong	No. of Days Outside Hong Kong
8-3-1990	1-5-1990	30
6-5-1990	15-5-1990	9
20-5-1990	24-5-1990	4
28-5-1990	9-6-1990	12

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14-6-1990	18-7-1990	34
25-7-1990	1-8-1990	7
26-9-1990	28-9-1990	2
25-10-1990	27-10-1990	2
6-11-1990	9-11-1990	3
12-11-1990	13-11-1990	1
20-11-1990	24-11-1990	4
12-12-1990	15-12-1990	3
3-1-1991	19-1-1991	16
23-1-1991	26-1-1991	3
20-2-1991	23-2-1991	3
26-2-1991	8-3-1991	10
15-3-1991	19-3-1991	4
20-3-1991	23-3-1991	3
27-3-1991	29-3-1991	2

Travel Schedule for year ended 31 March 1992

Date Out of Hong Kong	Date in Hong Kong	No. of Days Outside Hong Kong
10-4-1991	18-4-1991	8
1-5-1991	4-5-1991	3
20-5-1991	1-6-1991	12
18-7-1991	27-7-1991	9

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28-8-1991	31-8-1991	3
8-10-1991	10-10-1991	2

We accept that the Taxpayer took the trips as particularised in the 'Travel Schedule'.

19. The Taxpayer paid his first visit to Company L in Country J about the Country K project on 20 February 1991. Prior to the visit, he had been informed by the Country B headquarters by electronic mail that Company L had sent a RFP (request for a proposal) for the Country K project. Normally communications between the Country B headquarters and the Taxpayer were by electronic mail while the Taxpayer would use the telephone to communicate with customers in the Region. Having received the message from the Country B headquarters, the Taxpayer called Company L for an appointment and went on his first visit, and that was Step 1 in the 'Normal Procedure' (see paragraph 17 above). At the destination, he looked at maps of Country K, identified the major cities and the industrial areas and considered the demographics and how the population was distributed. With those details, he worked out a basic idea of how to set up a data communication network. Having done that, he proceeded to Step 2: with his portable computer, he communicated the customer's requirements to the Country B headquarters by electronic mail from his hotel room in Country J right after the meeting. Step 2 was always taken in the customer's city right after the meeting in order to take advantage of the time difference between that city and Country B, so that clarification or more information could be provided to the Country B headquarters as required when the Taxpayer was still in the customer's city. So much for the first visit which covered Steps 1 and 2.

20. Step 3 was the stage where the Country B headquarters had worked out the project proposal and was sending it to Company L. Prior to Step 3, there were instances where communications by electronic mail passed between the Country B headquarters and the Taxpayer in Hong Kong relating to matters requiring clarification or further information or otherwise concerning the making of the proposal.

21. The second visit to Country J was the first of the follow-up visits comprised in Step 4. The Taxpayer was evasive; his evidence as to the surrounding circumstances of the second visit was punctuated with contradictions and inconsistencies. We accept his evidence that normally the Country B headquarters would send him a copy or draft copy of the proposal. We accept his evidence that he went on the second visit on 15 March 1991 and that a day or two before his departure, he had received a copy of the proposal for the Country K project from the Country B headquarters. For reasons that will appear later, we do not accept his evidence to the effect that, as he was going to present only one part of the proposal to the Company L meeting, he only read that part in detail, that the rest of the proposal was going to be presented by his two colleagues, a vice president of International Sales Division and a system engineer, both from the Country B headquarters or that the three of them met in Country J on 15 March 1991 to attend the meeting. Nor do we accept his evidence given eight days later at the adjourned hearing, when the Taxpayer asserted

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that for the Country K project he never received a copy of the proposal before he left for Country J because his colleague was bringing the whole proposal to Country J. Nor do we accept his evidence when, after his previous evidence was read back to him, he stated that he only received a part of the proposal, that is, the technical part which he needed to talk about, that he had nothing to do with prices and terms and that he did not even know how much the whole project was going to cost the customer.

21.1 But we accept his evidence when at last he stated that normally the first couple of follow-up visits would be all by himself-

‘to find out what the reaction is from the client;’ and that

‘when I set the prices and the terms, it’s like an indication as to whether it’s too expensive.’

We also find that on prices and terms, he would refer back to headquarters by electronic mail because basically he could not provide an answer.

21.2 We find that, in the case of the Country K project, the Taxpayer did what was normally done, that he attended the Company L meeting on 15 March 1991 by himself and presented the whole proposal to the meeting by himself, that, before his departure from Hong Kong, he had received a copy of the whole proposal and had worked on it in preparation for the presentation and that at the meeting, he had discussions with Company L on all aspects of the proposal, that is, the technical proposals, prices and terms.

22. We find that, in the case of the Country K project, there were three follow-up visits in Step 4, and that the third visit commencing on 10 April 1991 and the fourth visit commencing on 20 May 1991 were the second and third follow-up visits in Step 4 and were the continuation of the first follow-up visit which had commenced on 15 March 1991.

23. Step 5 concerned negotiation of contract terms. In the case of the Country K project, Step 5 was taken during the Taxpayer’s fifth visit which commenced on 18 July 1991. Three persons took part in the negotiation on behalf of the Country B group: a vice president and a lawyer from the Country B headquarters to look after pricing and terms and the Taxpayer who was responsible for the technical side and what was included in the system that was being offered.

24. Step 6 corresponds with the sixth visit which commenced on 28 August 1991, the purpose being to resolve a payment term problem and to finalise the contract terms. The contract was signed during the visit.

25. Neither the ‘Normal Procedure’ nor the ‘Travel Schedule’ reveals anything which the Taxpayer did in his office in Hong Kong. We accept the Taxpayer’s evidence that his Hong Kong office measured 100 square feet, that in that office he was provided with a computer, a telephone and a fax machine but that he had no secretary or other staff of his own. The Taxpayer stated at one point in his evidence that he did not do a lot in Hong Kong,

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and later that he did nothing at all in Hong Kong. We do not accept those statements as representing the true position. Towards the end of his evidence the same question was gone into again. He was asked what he did in the Hong Kong office during a six-week interval between the fourth and fifth visits to Country J. The Taxpayer's answer was that what he did while he was in Hong Kong 'includes checking e-mails and making phone calls'; he agreed that all those things he did in Hong Kong were in one way or another connected with his sales in the Region.

26. The Taxpayer had the following to say about the role played by the electronic mail:

'When you need to go after a sales contract, and also in making a proposal or an offer to a customer you involve different people from different departments. Say like, technical department, planning department and even the drawing office and then there is a proposal team who type the proposal itself and all legal office who lay down the terms and things like that.'

Mr Bale then asked, 'So what part did you play in bringing all these specialities together? Were you the leader of this?' The Taxpayer's answer was:

'Yes because if they don't support me to get this done and things to conclude the contract I will never get the commission and may be that is one of the reasons I work very hard by sending out e-mail because you have to push those people. I did all those because I had to.'

27. The Taxpayer was employed to generate sales of the products of the Country B group. To encourage him in his task, he was paid a commission income the size of which depended on the volume of the sales he achieved. His operations and activities were based in Hong Kong where he had set up an office which existed for the sole purpose of facilitating the sales. In that office the computer and the telephone were his chief instruments with which to provide such impetus as he could to the ongoing process of making proposals, carrying on discussions and negotiations and, finally, obtaining the contract. He rendered services in Hong Kong not only in sending out and receiving messages, but also in checking and waiting for them and in generally getting ready for the business of the next meeting. All in all, in our view, the Taxpayer derived his income – commission and all – from his services rendered in Hong Kong as well as outside Hong Kong.

Apportionment of income

28. The revised assessments under appeal were arrived at by the adoption of the 'time in time out' apportionment basis which treats income as accruing at an even rate from day to day. As the Commissioner pointed out, it is a basis which has been followed consistently by the Inland Revenue Department for many years. We note that it was also adopted in CIR v Goepfert 2 HKTC 210. It may be that the basis can be precluded by an express provision in the employment contract. However, as the Commissioner again

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pointed out, there was nothing provided in the present employment contract that specifically allocated the income in relation to the services rendered by the Taxpayer inside and outside Hong Kong and required the conclusion that those services rendered outside Hong Kong justified a higher rate of income. We will go further and say that there was nothing in the whole of the evidence which required such a conclusion.

29. In his final submission, the Taxpayer stated that his income, whether it be salary, allowance or commission, had nothing to do with his living and working in Hong Kong, that may be the so-called work was only the use of the telephone and the electronic mail, that the majority if not all of the work was done outside Hong Kong, and that, if the law still required him to pay tax in Hong Kong, the 'time in time out' basis was unfair. The Taxpayer did not put forward any alternative apportionment basis. For reasons already stated, we are unable to accept his contentions.

Conclusion

30. At the end of the day, the question is: Has the Taxpayer proved on a balance of probabilities that the revised assessments are incorrect or excessive? We think not.

Decision

31. It follows that this appeal fails and that the assessments in question are hereby confirmed.