Case No. D54/90

Salaries tax – whether taxpayer an employee or carrying on business.

Panel: Robert Wei QC (chairman), Colin Cohen and Graeme Large.

Dates of hearing: 19 and 20 October 1990.
Date of decision: 4 January 1991.

The taxpayer entered into an agreement with a company under which he was described as an account manager and subsequently was designated as assistant marketing manager. His duties consisted of soliciting orders for investing or trading in bullion or foreign currencies. The details of the contract appear in the Board decision. The taxpayer was assessed to salaries tax on the basis that he was an employee. The taxpayer argued that he was not an employee and that his income should be subject to profits tax.

Held:

On a true construction of the contract the taxpayer was not an employee but was providing services and accordingly the appeal was successful and the assessment annulled.

Appeal allowed.

Cases referred to:

Market Investigations v Minister of Social Security [1969] 2 QB 173
Montreal v Montreal Locomotive Works Ltd [1947] 1 DLR 161
Bank voor Handel en Scheepvaart NV v Slatford [1953] 1 QB 248
United States of America v Silk [1946] 331 US 704
Ready Mixed Concrete Ltd v Minister of Pensions and National Insurance [1968] 2 QB 497
NG Pik-yuk v Wai Tai Knitwear Ltd [1988] 2 HKLR 109

Jennifer Chan for the Commissioner of Inland Revenue.
Teresa Lau Mei Po for the taxpayer.

Decision:

This is an appeal by a taxpayer against the Commissioner of Inland Revenue's determination dated 24 July 1990 confirming the salaries tax assessment for the year of assessment 1988/89 raised on him on the ground that during the accounting period he derived his income from the carrying on of a business.

2. The Taxpayer gave evidence on his own behalf. No other witness was called.

3. The facts may be summarised as follows.

3.1 The Taxpayer was appointed as the trading agent of X Limited ('X Ltd') under an agreement dated 4 May 1988 made between the parties.

3.2 He was given the designation of account manager until 1 October 1988 when was given the higher designation of assistant marketing manager.

3.3 His duties consisted of soliciting on behalf of X Ltd clients' orders for investing or trading in bullion or foreign currencies which orders were processed by X Ltd, supplying market information to clients and recruiting, supervising and monitoring his own team of subordinates to develop business and clientele.

3.4 He was not entitled to any employment benefit or paid leave; his working hours depended on the trading hours of markets around the world.

3.5 He was provided with a desk and a telephone extension in X Ltd's office but had no access to secretarial services.

3.6 He was not required to attend the office regularly.

3.7 He was paid a basic allowance (first at the rate of $5,000 per month as account manager and later at $7,500 per month as assistant marketing manager) and commission at fixed rates on orders he procured from clients. X Ltd had the right to stop paying the basic allowance if he failed to bring in business. During the accounting period the allowances accounted for about half of his total income while the other half was commission.

3.8 Orders were confirmed in clients' offices, entertainment places or X Ltd, but mostly in clients' offices.

3.9 He lived with his father and younger brother, both of whom were employed by him as assistants, the former on a full time basis at $3,000 per month and the latter on a part time basis also at $3,000 per month. Both engaged in the same

sort of work, that is, gathering and passing on to clients information and comments on markets and trends.

3.10 There was no reimbursement of entertainment expenses which amounted to $2,000 to $3,000 per month.

3.11 Apart from the telephone, X Ltd provided the Taxpayer with forex information paging and a Reuters machine. In addition, he used his own pager and mobile telephone for which he incurred capital outlay and running expenses which were not reimbursed.

3.12 If a client's margin was exceeded by the amount of any loss he had made on his investment and he failed to make up the shortfall, the agent would have to bear the loss. This did not happen to the Taxpayer personally, although it happened to some of his colleagues.

4. The parties' representatives relied on one or the other of the above facts and various provisions of the agreement as factors in support of their respective contentions on the question whether the Taxpayer was an employee working under a contract of service or an independent contractor working under a contract for services. The matter is governed by the principles expounded by Cooke J in Market Investigations v Minister of Social Security [1969] 2 QB 173 at 184. He first referred to what Lord Wright said in Montreal v Montreal Locomotive Works Ltd [1947] 1 DLR 161 at 169 about the crucial question being whose business it is, or whether the party is carrying on the business, in the sense of carrying it on for himself or on his own behalf and not merely for a superior. He then referred to Denning LJ's observation in Bank voor Handel en Scheepvaart NV v Slatford [1953] 1 QB 248 at 295:

> 'The test of being a servant does not rest nowadays on submission to orders. It depends on whether the person is part and parcel of the organisation.'

The last case he referred to was United States of America v Silk [1946] 331 US 704, where the judges of the Supreme Court decided that the test to be applied was not 'power of control, whether exercised or not, over the manner of performing service to the undertaking' but whether the men were employees 'as a matter of economic reality'.

Cooke J then had this to say:

> 'The observations of Lord Wright, of Denning LJ and of the judges of the Supreme Court suggest that the fundamental test to be applied is this: "Is the person who has engaged himself to perform these services performing them as a person in business on his own account?" If the answer to that question is "yes", then the contract is a contract for services. If the answer is "no", then the contract is a contract of service. No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of the considerations which are

> relevant in determining that question, nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases. The most that can be said is that control will no doubt always have to be considered, although it can no longer be regarded as the sole determining factor; and that factors which may be of importance are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk he takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task.'

5. Factors relating to control Mrs Chan, the Commissioner's representative relied on clauses 2, 4, 12 and 13 of the agreement as examples of control by X Ltd over how the work was to be done by the Taxpayer. Clause 2 required him to exercise care and skill in the performance of his duties and to act faithfully on behalf of X Ltd. Clause 4 gave X Ltd the right to limit the volume of the Taxpayer's trading and to decline to process new orders pending settlement of existing positions. In view of the nature of the Taxpayer's work, the purpose of clause 4 was obviously to protect X Ltd's financial interests. Clause 12 required the Taxpayer to report in writing to X Ltd every month upon the conduct and development of his business and to make such interim special reports as X Ltd might from time to time require. Clause 13 was an undertaking by the Taxpayer to abide by X Ltd's rules and regulations governing conduct in the office, transactions and all other matters. No such rules or regulations were produced, so there is no way of evaluating clause 13. As for clauses 2, 4 and 12, they did not impose control over the manner in which the work was to be done, nor was the control imposed of such a degree or extent as to suggest that the Taxpayer was working under a contract of service.

6. Labelling factors Mrs Chan relied on the fact that the Taxpayer was account manager and later promoted to assistant marketing manager and the fact that X Ltd filed an employer's return in which the Taxpayer was shown to be employed as 'marketing manager' as pointers to the Taxpayer working under a contract of service. On the other hand, Miss Lau the Taxpayer's representative pointed out that by the agreement the Taxpayer was engaged as a 'trading agent', that X Ltd and the Taxpayer were referred to as 'the principal' and 'the agent' throughout the agreement, that in the employer's return the nature of the Taxpayer's income was stated to be 'allowances and commission' and that clause 18 of the agreement declared that the agreement 'will under no circumstances be construed as creating between the parties the relationship of employer and employee'. In our view, the expressions 'account manager' and 'assistant marketing manager' are designations to show the Taxpayer's rank, while the expressions 'trading agent' and 'agent' are descriptions to show the Taxpayer's representative capacity: standing by themselves, these expressions do not necessarily point to the Taxpayer being an employee in one case or an independent contractor in the other. A similar ambivalence may be attributed to the words 'allowances' and 'commission'. However, we cannot help noticing that clause 9 of the agreement which was an undertaking by the Taxpayer not to function as an employee or agent for any other brokerage house during the subsistence of the agreement may be said to provide a context

for arguing that by the word 'agent', the parties meant 'non-employee' or 'independent contractor'. As for clause 18, it is a clear declaration of the contract being one for services, and may be said to colour the word 'agent' accordingly. (It might have been a labelling factor to consider whether X Ltd had at the material time an insurance policy in force in relation to the Taxpayer as an employee under the Employees' Compensation Ordinance, but there was no evidence either way.) However, labelling factors are generally to be ignored and will only become relevant if the other factors do not show clearly to which category the contract belongs (Ready Mixed Concrete Ltd v Minister of Pensions and National Insurance [1968] 2 QB 497 at 512, cited in NG Pik-yuk v Wai Tai Knitwear Ltd [1988] 2 HKLR 109 at 112). So the relevance or otherwise of the labelling in the present case must await the weighing of all the other factors.

7. Economic reality factors These factors are relevant to the determination of the question whether the Taxpayer was in business on his own account. To start with, the fact that clients concluded their transactions with X Ltd although they gave their instructions to the Taxpayer is in our view of little significance. As a trading agent, the Taxpayer worked on behalf of X Ltd so that the clients were in the final analysis the customers of X Ltd, but it is an entirely different question whether the Taxpayer worked as such an agent under a contract of service or a contract for services. In support of her contention that the Taxpayer did not carry on business on his own account, Mrs Chan referred to the fact that the Taxpayer was engaged on a continuing basis rather than for the performance of a specified task and to the Taxpayer's undertaking under clause 9 not to work for any other brokerage house during the subsistence of the agreement. On the other hand, as pointers in the other direction, Miss Lau pointed out:

(1) That as part of his equipment he purchased his own pager and mobile telephone for which he incurred capital outlay and running expenses;

(2) That he hired his own helpers, that is, his father and younger brother;

(3) That he regularly incurred entertainment expenses;

(4) That he was not entitled to any employment benefits associated with a contract of service or employment such as leave entitlements (which are statutory benefits provided by the Employment Ordinance) and medical benefits; and

(5) That he faced financial risks in that he gave a full indemnity to X Ltd under clause 7 of the agreement against all loss incurred by X Ltd by the orders placed with X Ltd under the direction or authorization of the Taxpayer, that if a client's margin was exceeded by the amount of the loss he had made on his investment and he failed to make up the shortfall, the agent had to bear the loss, and that this happened to some of his colleagues, although it did not happen to the Taxpayer.

Furthermore, in our view, by reason of the nature of the Taxpayer's work which was the procurement of clients and trading orders, his opportunity of earning commission income must have depended significantly on the way he managed his work.

8. It seems that the factors in favour of a contract for services outweigh those in favour of a contract of service. In any event, if there were any doubt on the matter, clause 18 (see paragraph 6 above) would in our view resolve that doubt in favour of finding a contract for services. It follows therefore that this appeal succeeds and that the assessment in question is hereby annulled.