Case No. D56/91

Salaries tax – taxpayer employed in Hong Kong but performed services in the P.R.C. Income attributable to services in the P.R.C. taxed in the P.R.C. – Hardship allowance – whether included in P.R.C. taxable income.

Panel: William Turnbull (chairman), Chiu Chun Bong and Norman Ngai Wai Yiu.

Dates of hearing: 28 and 29 August 1991.
Date of decision: 1 November 1991.

The taxpayer was employed by a company in Hong Kong. He performed some of his services in the Peoples' Republic of China. He was paid a hardship allowance in respect of the period that he was required to work in the Peoples' Republic of China. The hardship allowance was calculated with direct reference to the period of time which the taxpayer spent in the Peoples' Republic of China. The taxpayer was assessed to tax by the Peoples' Republic of China in respect of the income which he earned for the services which he provided there. The taxpayer claimed a deduction from his taxable emoluments in Hong Kong in respect of the income which he claimed had been the subject matter of assessment to tax in the Peoples' Republic of China by virtue of section 8(1A)(c) of the Inland Revenue Ordinance. The assessor would only allow a proportion of the hardship allowance to be deducted from the taxable income of the taxpayer in Hong Kong on the ground that only part thereof had been assessed to tax in the Peoples' Republic of China. The taxpayer appealed to the Board of Review.

Held:

The tax law of the Peoples' Republic of China assessed to tax the entirety of the income which the taxpayer received in respect of the services which he rendered in the Peoples' Republic of China. This included the hardship allowance which he received. It was clear as a matter of fact that the entirety of the hardship allowance was paid to the taxpayer in respect of the services which he had rendered in the Peoples' Republic of China. The fact that under the procedures adopted in the Peoples' Republic of China when calculating the tax to be assessed, a percentage or fraction was applied to the taxpayer's emoluments with the effect that a reduced rate of tax applied to the hardship allowance did not mean that the same had not been assessed to tax in the Peoples' Republic of China.

Appeal allowed.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case referred to:

CIR v Robert P Williamson 1 HKTC 1215.

K A Lancaster for the Commissioner of Inland Revenue.
Alice Chan of Price Waterhouse Tax for the taxpayer.

Decision:

This is an appeal by a taxpayer against two salaries tax assessments for the years of assessment 1987/88 and 1988/89 wherein the assessor has included part of a 'hardship allowance' paid to the Taxpayer and which the Taxpayer claims arose solely from his services in China. The facts of the case are as follows:

1. During part of the year of assessment 1987/88 and the whole of the year of assessment 1988/89, the Taxpayer was employed as an account executive by a company in Hong Kong. It was accepted by the Taxpayer that his employment was Hong Kong employment and that for the purposes of the Inland Revenue Ordinance, the income which he earned from his employment arose in or was derived from Hong Kong.

2. In the course of his employment, the Taxpayer was required to render services in the People's Republic of China, and it was a term of the employment contract of the Taxpayer that he would be paid a 'hardship allowance' for any period that he was required to work in the People's Republic of China. The 'hardship allowance' was calculated and paid in accordance with a formula which was one-thirtieth of the monthly base salary of the Taxpayer multiplied by the number of days that he spent working in China. In calculating the number of days, it was deemed to be a complete day if he spent all or any part of a day in the People's Republic of China.

3. In each of the two years of assessment in question, the Taxpayer spent more than 60 days in the basic period for the year of assessment in Hong Kong and accordingly all of his income was assessable to salaries tax in Hong Kong subject to the provisions of section 8(lA)(c) of the Inland Revenue Ordinance. The Taxpayer paid tax in the People's Republic of China and claimed a deduction from his taxable income of that part thereof which he earned in respect of the services which he had rendered in the People's Republic of China and which he claimed had been taxed by the People's Republic of China.

4. The assessor conceded that part of the income of the Taxpayer should be excluded from the charge to Hong Kong salaries tax by virtue of section 8(lA)(c) of the Inland Revenue Ordinance and decided that the total income of

the Taxpayer should be apportioned in the ratio which the days he spent in Hong Kong bore to the days which he spent in the People's Republic of China. In the year of assessment 1987/88, the Taxpayer spent 36 days out of a total number of 152 days during which he was employed in Hong Kong and accordingly the assessor excluded

$$\frac{36}{152} \times \text{Total income of the Taxpayer.}$$

In respect of the year of assessment 1988/89, the Taxpayer spent 142 days out of the whole year in the People's Republic of China and accordingly the assessor excluded

$$\frac{142}{365} \times \text{Total income of the Taxpayer.}$$

5. In deciding the total income of the Taxpayer the assessor took the total emoluments of the Taxpayer during the periods in question including the entirety of the 'hardship allowance' which had been paid to the Taxpayer.

6. The Taxpayer objected to the assessment on the ground that the entirety of the 'hardship allowance' had been earned by him and paid to him in respect of the time which he spent in China and should be wholly deducted from his income assessable to salaries tax by virtue of the provisions of section 8(1A)(c) of the Inland Revenue Ordinance.

7. By his determination dated 2 April 1991 the Deputy Commissioner rejected the objection of the Taxpayer. The Taxpayer duly appealed to this Board of Review.

At the hearing of the appeal, a witness was called to give evidence for the Taxpayer. The witness was currently the general manager of the internal audit department of a company in Hong Kong but had previously up to late 1989 held a senior position in the foreign taxation branch of the Chinese Government. From the evidence given by this witness, we find the following additional facts:

1. The witness had held a senior position in the foreign taxation branch of the Chinese Government for the period 1975 to 1989. During that period he was in charge of the levying and management of all foreign taxation in a municipality including income tax on individuals.

2. Where an individual who is a Hong Kong employee works in China, he is considered to be a temporary Chinese visitor. According to the Individual Tax Regulations of the People's Republic of China, any temporary Chinese visitor who works for a consecutive or cumulative period of over 90 days in the People's Republic of China will be liable to pay income tax in the People's Republic of China.

3. According to the tax law of the People's Republic of China, an individual who spends part of a month working in the People's Republic of China will be required to submit a tax return showing the total income which he had earned in that month including wages, salary, bonuses and other incomes. Subject to the tax authorities in the People's Republic of China having accepted and agreed to the total income declared by the person as being his correct income, the individual would then be assessed to tax which would be calculated in accordance with a statutory or regulatory formula which was as follows:

   Amount of tax payable

   = [(total income x tax rate) - fast calculation amount]

   $$\times \frac{\text{days in PRC}}{\text{days in month}}$$

4. An individual who is a temporary Chinese visitor is taxable only on the income which he derives for his work and services performed in the People's Republic of China.

5. To determine what income relates to the services which an individual performs in the People's Republic of China is a rather complex issue. It concerns a consideration of whether the services are rendered in China or whether the individual is resident in China, the period of stay of the individual in China and whether his income is derived from services in China. One example given by the witness was an individual who stays in China in a tax year for 90 days and is accordingly a temporary Chinese visitor. If in any particular month such person only stays in the People's Republic of China for 10 days and his wages are calculated on a daily basis, then in that case the daily wages are multiplied by 10. But according to the stipulations of the General Tax Bureau of the Ministry of Finance, such individual when he files his tax return must 'gross up' his daily wages to one month, that is, he must multiply his daily wage by 30 and declare his monthly wage as being for a period of 30 days. This is then counted as the taxable income for that particular month for the purpose of applying the formula set out in fact 3 above. Accordingly, in his tax return, the individual does not declare the actual amount received by him for the services which he rendered in China but a notional amount which he would have received if he had performed his services for 30 days in the People's Republic of China. Regardless of whether a person is paid on a daily, weekly, fortnightly, or monthly basis, the remuneration which he receives for his services in the People's Republic of China must be converted into a monthly 30 day unit for the purpose of enabling the authorities to assess tax.

6. After receiving the monthly tax return in respect of the individual and having confirmed and checked that the information contained therein is correct, the appropriate authority will then apply the formula to the remuneration for the month as so ascertained and issue a demand note for payment of the tax assessed. Though the demand note is in a printed form with spaces for the details, the only accurate figure contained in the tax demand form is the amount of tax paid or payable. There are no hard and fast rules as to how the rest of the information is to be completed on the tax demand form and the only Government requirement is that the amount of tax due and paid must be correctly stated.

7. Because the Ministry of Finance stipulates that the tax of an individual must be calculated with reference to a 30 day monthly amount, it is necessary to calculate such an amount with reference to the hourly, daily, weekly or monthly amount earned by the individual for his services in China with the intent and object of the stipulations of the Ministry of Finance being to tax whatever income the individual has received and which has been derived from the services which he has rendered in the People's Republic of China.

In addition to the foregoing witness, the human resources director of the employer of the Taxpayer was also called to give evidence. He confirmed that the 'hardship allowance' paid to the Taxpayer was in respect of the time which he spent in China only and was not paid to him in respect of any time which he did not spend in China.

Copies of the tax returns filed in respect of the Taxpayer in the People's Republic of China were tabled as exhibits. These set out in respect of each month where the Taxpayer spent part of his time in the People's Republic of China, the following information, namely, the month, the total salary for the month, the total 'hardship allowance' for the month, the days in China, and the days in the month. Based on this information converted into Chinese currency, the amount of tax payable was calculated. Apparently the tax authorities of the People's Republic of China accepted the tax returns filed in respect of the Taxpayer and tax was duly assessed and paid thereon. What we will call the tax assessment or demand note was a printed form entitled 'tax completion certificate' on which were stated the period covered, the amount of income, the rate of tax and the tax payable. It was clear from the face of the 'tax completion certificates' which were tabled before the Board that there were substantial differences in the way in which the information had been completed and in some cases all information was stated as zero except for the calendar period in question and the amount of tax payable.

At the hearing of the appeal, the Taxpayer was represented by his tax representative who submitted that the assessor had incorrectly assessed to tax in Hong Kong part of the 'hardship allowance' which had been received by the Taxpayer and which was paid to the Taxpayer only in respect of the services which he rendered in China. She pointed out that under section 8(1A)(c) of the Inland Revenue Ordinance certain matters have to be satisfied. For convenience we set out the wording of section 8(1A)(c) as follows:

‘ 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 …

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

…

(c) Excludes income derived by a person from services rendered by him in any territory outside Hong Kong where-

(i) by the Laws of the Territory where the services are rendered, the income is chargeable to tax of substantially the same nature as salaries tax under this Ordinance; and

(ii) the Commissioner is satisfied that the person has, by deduction or otherwise, paid tax of that nature in that territory in respect of the income.’

The representative for the Taxpayer submitted that the Taxpayer had been required to perform services in the People’s Republic of China on a regular basis and had paid tax on his income earned in China, which tax was substantially the same as Hong Kong salaries tax. She pointed out that the ‘hardship allowance’ was wholly attributable to the services rendered by the Taxpayer in the People’s Republic of China and had no relevance whatsoever to the services which he rendered in Hong Kong. Accordingly, the ‘hardship allowance’ should be excluded in its entirety when assessing the income of the Taxpayer to salaries tax. She pointed out that the whole of the ‘hardship allowance’ had been declared to the authorities in the People’s Republic of China for taxation purposes and had been assessed according to the relevant laws of the People’s Republic of China.

The representative for the Commissioner submitted that the wording of section 8(1A)(c) of the Inland Revenue Ordinance is quite clear. He said that there are three requirements, namely:

(1) that the Taxpayer derived income from services overseas,

(2) that the Taxpayer was chargeable to tax of a similar nature to salaries tax, and

(3) that the Taxpayer paid tax on such income.

It appeared that the Commissioner accepted that the Taxpayer derived income from services overseas and that the tax charged on individuals in the People’s Republic of China was of a similar nature to salaries tax. The question to be decided was the income on

which the Taxpayer had paid tax in the People's Republic of China. He submitted that the facts show that the Taxpayer only paid tax on part of the 'hardship allowance' which he received. He pointed out that the Chinese authorities calculated the tax on the basis of the time the Taxpayer spent in China and did not calculate the tax on the basis of the amount which the Taxpayer derived from working in China. As the amount which the Taxpayer derived from performing his services in the People's Republic of China is greater than the amount which is calculated by reference to the time which the Taxpayer spent in the People's Republic of China, he did not pay tax in the People's Republic of China on the larger sum namely all of the 'hardship allowance' but on the smaller sum namely part of the 'hardship allowance' calculated by reference to the days which the Taxpayer spent in China. Accordingly he submitted that the assessor was correct in assessing to tax in Hong Kong part of the 'hardship allowance' because only part had been taxed in China.

A submission was also made by the representative for the Taxpayer that apportionment was not permitted on the authority of CIR v Robert P Williamson 1 HKTC 1215. That case related to whether or not a rental deduction should be apportioned according to the time that a taxpayer spent in Hong Kong. The Court held that as it had not been disputed that rent paid was solely referrable to the Hong Kong residence, the full amount should be allowed as a deduction. With due respect though by coincidence, it may be that the result of the facts of this case and of the Williamson's case are similar, we cannot find any authority for the proposition that income is not to be apportioned under section 8(1A)(c) of the Inland Revenue Ordinance. Indeed, the contrary would appear to be the case because it is quite clear that the meaning and intent of the Inland Revenue Ordinance is to allow a person to deduct from his income assessable to Hong Kong salaries tax that part of his income which has been taxed elsewhere. The last two words 'the income' clearly refers to the first word, namely, 'income derived by a person from services rendered by him in any territory outside of Hong Kong'. This must refer to that part of his income which relates to services performed overseas. It cannot mean that all of the income must relate to services overseas because this would make the provision an absurdity. Likewise it cannot mean that if any part of the services are performed overseas, then none of the income can be taxed in Hong Kong because this would be equally absurd.

The question which we have to decide in this case is a very precise one which depends entirely upon the factual interpretation of the taxation law of the People's Republic of China. We were very fortunate to have the benefit of such an important and senior witness as the former senior official of the foreign taxation branch of the Chinese Government. The witness spoke with authority and clearly was fully conversant with all of the relevant tax laws of the People's Republic of China. In his evidence he made it clear that the People's Republic of China had a comprehensive system of taxation similar to our salaries tax. Accordingly, we find that the tax payable in China was of substantially the same nature as salaries tax chargeable under our own Inland Revenue Ordinance.

The witness made it clear that the tax laws of the People's Republic of China in the case of individuals who were classed as temporary Chinese visitors imposed a tax on all of the income which such person earned in respect of the services provided by such person

in the People's Republic of China. That was the principle or rule of paramount importance to which the witness referred. He stated clearly and categorically that the assessment procedure was to ascertain the daily amount which the individual earn in respect of his services in the People's Republic of China and then gross that amount up so that it would be equivalent to a unit of 30 days.

It is not for us as a Board of Review sitting in Hong Kong to consider or pass judgment on taxation matters in the People's Republic of China. It would appear to us that perhaps the authorities in the People's Republic of China in the way that they have applied the formula in the present case may have charged less tax than they might otherwise have been entitled to do. Alternatively, it may be that the Taxpayer has taken advantage of a tax planning procedure which has enabled him to reduce the amount of tax which he has had to pay in China. However, this is not relevant to the question which we have to answer. The question which we have to answer is whether or not the Taxpayer has paid tax in the People's Republic of China on the 'hardship allowance' which was paid to him in respect of the services which he performed in the People's Republic of China.

It is clear on the facts before us that the 'hardship allowance' was earned by and paid to the Taxpayer only in respect of services which he rendered in the People's Republic of China and nowhere else. The Commissioner's representative attempted to suggest otherwise but there is no foundation of fact for what he tried to suggest. The evidence of the human resources director and the papers before the Board made it quite clear that the 'hardship allowance' was paid to the Taxpayer in respect of the period which he spent in China only and for no other period. Though he received a full day's allowance in respect of a day partly spent in China, we do not consider this material. It was clear that the allowance was paid in respect of the time which he spent in China and not the time which he spent in Hong Kong. His employment terms were that he was entitled to a whole day's allowance for a whole day or any part of a day which he spent in China. Nothing could have been plainer.

It would appear to us that according to the tax laws of the People's Republic of China when calculating his tax liability the relevant authorities should have taken one-thirtieth of his base pay for a month plus the whole of one day's 'hardship allowance'. This would have represented the actual amount which he had earned in the People's Republic of China. This figure would then have been multiplied by 30 and used in the application of the formula to calculate his tax liability. However, whether our view of this is correct or incorrect is not material. The fact is that the Taxpayer fully disclosed his monthly salary and the amount of the 'hardship allowance' which he received. The total amount was then subject to tax in the People's Republic of China and they assessed to tax the total amount of his 'hardship allowance' according to their relevant procedures.

In our opinion the Taxpayer has declared for tax purposes in China the whole amount of his 'hardship allowance' and the whole amount of his 'hardship allowance' has been subject to and assessed to tax according to the procedures of the taxation authorities in the People's Republic of China. It is a fact that the 'hardship allowance' relates only to services in China and has no relevance to services in Hong Kong. In such circumstances we

find in favour of the Taxpayer and direct that the two assessments against which the Taxpayer has appealed should be remitted back to the Commissioner to be reduced by the total amounts of the 'hardship allowances' paid to the Taxpayer during the two years of assessment 1987/88 and 1988/89, namely, $18,327 and $70,338 respectively.

In reaching our decision, we have considered that it would be inappropriate for a Board of Review in Hong Kong or indeed an assessor or the Commissioner for the purposes of section 8(1A)(c) of the Inland Revenue Ordinance to be required to look beyond the clear meaning and intent of the tax law of an overseas country. We do not believe that it was the intention of the legislature that the Commissioner is to be more than prima facie satisfied that a person has paid tax in that territory in respect of the income and that it should not be necessary to investigate beyond ascertaining the fact that the Taxpayer in question has duly declared for assessment purposes the whole of the income in question and that the tax authorities have duly assessed and taxed the whole of that income according to their practices and procedures. We believe that it would be invidious for the Commissioner or ourselves to investigate further into whether or not a person has or has not been correctly taxed according to the laws of an overseas territory.