

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D59/95

**Salaries tax** – salaries tax or profits tax – film production contract.

Panel: Audrey Eu Yuet Mee QC (chairman), Benjamin Kwok Chi Bun and William Sing Tsun Zao.

Date of hearing: 1 September 1995.

Date of decision: 18 September 1995.

The taxpayer signed a contract for the production of films. A business said to be ‘film production’ was registered with the name of the taxpayer as the company name. An employer’s return was filed by the company contracting with the taxpayer. The taxpayer filed a profits tax return. The Commissioner maintained that the taxpayer should be assessed to salaries rather than profits.

Held:

The modern approach for differentiating between a contract of service and a contract for services was that there was no all-purpose test. No test was conclusive. Further, one must have regard to the peculiar facts of each trade, profession or industry and the facts of each case. The contract was one for services.

**Appeal allowed.**

Case referred to:

Hall v Lorimer [1994] 1 WLR 209

Tam Tai Pang for the Commissioner of Inland Revenue.  
Taxpayer in person.

**Decision:**

1. This is an appeal brought by the Taxpayer against the determination of the Commissioner dated 17 March 1995 in respect of the salaries tax assessment for the year of assessment 1992/93. The notice of appeal was dated 14 April 1995 but post-stamped 19 April 1995 and received on 20 April 1995, just outside the one month period under section

## INLAND REVENUE BOARD OF REVIEW DECISIONS

66 of the Inland Revenue Ordinance chapter 112. Mr Tam for the Commissioner does not object to the late notice and we formally extended period for the notice of appeal and proceeded to hear the appeal.

2. The sole issue is whether the Taxpayer should be assessed for salaries tax or profits tax.

### **A. FACTS**

3. The Taxpayer signed a contract ('the Contract') dated 20 May 1992 with Company A for the production of 4 films over a two year period. The terms of the Contract are germane to this appeal.

4. On 26 April 1992, the Taxpayer applied and got a business registration. The business was said to be 'film production' and the commencement date was said to be 22 April 1992. The name of this company is 'XXX', which is also the name of the Taxpayer. We shall call this the film production business.

5. On 20 April 1993, Company A filed an employer's return for the year ended 31 March 1993 in respect of the Taxpayer's salary during the material period totalling \$298,300.

6. On 19 November 1993, the Taxpayer filed a nil return for his salaries tax return for the same period.

7. On 15 February 1994, the Taxpayer filed a profits tax return for the same period in which he reported a total income of \$332,300 including \$278,300 received under the Contract, another \$20,000 received from Company A or its associate company for overseas distribution not covered by the Contract, and another \$34,000 from other production or film making companies. Set against this income are various expenditures totalling \$356,184.38 thus producing a loss of \$23,884.38. Obviously the same income from Company A under the Contract cannot be assessed twice. Mr Tam for the Commissioner informs us that the profits tax return had been processed and accepted without knowledge of the salaries tax assessment. He maintains that the Taxpayer should be assessed to salaries rather than profits tax as per the reasons stated in the determination.

### **B. THE EVIDENCE**

8. The Taxpayer produced various documents and gave evidence on his own behalf.

9. He rented the business address for two businesses; the business of the film production business and that of 'Company Y', a separate company which the Taxpayer also owns. The rent was equally shared between the two businesses. It was used as a correspondence address as well as a storage place for equipments, clothings, props, racks etc. The nature of the two businesses were different. Company Y was for special effects,

## INLAND REVENUE BOARD OF REVIEW DECISIONS

special props, special make-up etc. The film production business was for film production. They have different staff and different expenses. Company Y's profit tax return was produced and he went through the list of expenditures explaining the differences between the expenditures of the two businesses.

10. For the film production business, he incurred expenditure including business registration, consumable stores (cosmetics for artistes when they come for casting), decoration expenses (racks for storage), local travelling (including car rental and travelling expenses for assistants to search for locations etc), medical, rental, overseas research (looking for overseas locations), staff messing, staff salary, stationery, sundry, supplies and telephone.

11. The major expense relate to the hiring of the three employees whose ID card numbers and addresses are given. The Taxpayer produced appendix 8 being salary receipts signed by each of the three employees for the material period.

12. As for equipments, the Taxpayer said they included video cameras for location research purposes, costs of a computer programme for production budget, video tapes, instant cameras, mobile telephones etc. He produced appendices 9 and 10. Appendix 9 for the mobile telephone is dated July 1993, after the subject year of assessment.

13. The Taxpayer said that he worked for Company B for 5 years from 1983 to 1988 as one of their employees. He pointed out various differences between working as an employee for Company B and carrying on his film production business. While working as an employee, he received a monthly salary regularly and he enjoyed annual leave and double pay. Salary was fixed regardless of the number of films he took part in. He received a salary even if there was no work. As for the contract with Company A, he was remunerated for producing 4 films and he was paid by instalments. He received the balance of \$150,800 in one lump sum when the 4 films were completed. As an employee, he was not paid separately for overseas distribution. In the film production business, he received an extra sum of \$20,000 for the overseas distribution which was not covered in the Contract. While working as an employee, he needed to get prior written approval for leave whereas in the film production business, provided he could arrange for someone to take his place, he could be absent from Hong Kong. As an employee, he did not provide extra service for which he needed to incur expenses.

14. There is some controversy as to whether the Taxpayer needed to perform his service personally. Company A responded to the Commissioner's enquiry asserting that the Taxpayer was required to perform his duties personally. The Taxpayer disagreed. He said that he was only required personally to do liaison work, but if he was away from Hong Kong, he had to inform Company A so some people could do the liaison work. The Contract does state that XXX is not allowed to be absent without leave during filming. But in the written response to the Commissioner, Company A also said that it was possible for the Taxpayer to employ his own assistant 'to make work effience (sic)'.

### **C. THE LAW**

## INLAND REVENUE BOARD OF REVIEW DECISIONS

15. Mr Tam for the Commissioner provided a very careful written submission urging upon us various well known authorities and the three well-known tests for differentiating between a contract of service and a contract for services: the control test, the integration test or organization test and the economic reality test. The modern approach is that there is no all-purpose test. No test is conclusive. See Hall v Lorimer [1994] 1 WLR 209 which concerns a vision mixer doing work for production companies. Many different factors have to be taken into account. Further, one must have regard to the peculiar facts of each trade, profession or industry and the facts of each case. We must also keep in mind that under section 68(4) of chapter 112, the Taxpayer has the burden of proof.

### **D. THE ARGUMENTS**

16. The main points which the Taxpayer urged upon us are as follows:

- (a) The Contract does not include sick leave, annual leave or double pay.
- (b) There is no provision of payment in lieu of notice. There is instead a provision for 3 months' notice or a cash compensation of \$80,000.
- (c) Under clause 6, XXX could work for other companies.
- (d) Under clause 9, Company A could assign the benefit of the Contract to third parties.
- (e) A deposit was payable on the signing of the Contract. Upon completion, he received a lump sum of \$151,800.
- (f) It was not for a fixed period of 2 years but for the production of 4 films which could be shorter or longer than 2 years.
- (g) It was never publicly announced by Company A that XXX was its employee.
- (h) The terms of the Contract were common in the trade.
- (i) It was necessary for Company A to pay XXX expenses relating to overseas work as the location was not fixed and it would be impossible to predict the expenses necessitated by overseas work.

17. The main arguments put forward by the Revenue are as follows:

- (a) Clauses 5, 6 and 7 showed that Company A exercised strong control over the Taxpayer on where, when and how the work was to be done.
- (b) According to Company A's response to the Commissioner, the Taxpayer had to seek approval from the director before leave was taken, the Taxpayer had to

## INLAND REVENUE BOARD OF REVIEW DECISIONS

report his job and duties to the director and had to perform his duties personally.

- (c) The evidence shows that the taxpayer was an integral part of Company A's business.
- (d) The Taxpayer did not provide his own capital, he did not assume any financial risk. He did not have any opportunity of profiting from sound management in the performance of his duties. Nor did he undertake any degree of responsibility for investment and management as a person carrying on business of his own account.
- (e) Under the Contract, the Taxpayer was not required to provide his own equipment. As for the video camera, it was similar to what most families would nowadays have. The mobile phone is hardly a fancy business equipment. Further it was only purchased in July 1993. It is common for an employee to use his own equipment such as a personal computer. This must be distinguished from situations where a person carrying on business on his own account provides his own equipment.
- (f) Under the Contract, the Taxpayer was reimbursed for expenses relating to the production of the 4 films.
- (g) Under the Contract, the Taxpayer was not required to employ his own assistant. It is suspicious that each of the 3 assistants employed by the Taxpayer was paid the same \$45,000 which was just under the personal allowance limit. Further the salary was paid in cash and there was no bank record to prove the payment.
- (h) The heading of the Contract clearly describes it as a staff contract.
- (i) There were regular monthly payments under the Contract similar to salary payments.
- (j) It is possible for the Taxpayer to be employed as a staff of Company A and at the same time to carry on his film production business.

### **E. THE DECISION**

18. The reasons given by the assessor and the Commissioner for the salaries tax assessment essentially turned on the control test and to a certain extent the economic reality test. Little is mentioned about the organization test. In the context of a contract for producing a film or a number of films, the organization test is not really helpful.

19. Control, although a matter for consideration, is not decisive. Such controls as we see in this Contract are understandable in the context of film making. The producer of a film has to abide by the final decision of the director; the producer's presence during filming

## INLAND REVENUE BOARD OF REVIEW DECISIONS

is essential; clearly the producer must abide by stipulations shown in filming notices or seek approval before taking leave. Such control cannot mean that the relationship must be that of master and servant and that all production contracts must be contracts of service.

20. The Contract does not expressly provide for the taxpayer to be present in person. While it is said to be a staff contract, XXX is signed by the Taxpayer under a chop 'For and on behalf of' his film production business. The address is given as that of the film production business. Thus under the Contract, XXX could be present, not necessarily in the person of the Taxpayer, but through any of his employees or assistants.

21. We bear firmly in mind the possibility that a person can carry on a business and work as an employee at the same time and in the same line of business. The Taxpayer started the film production business only in April 1992. In order to develop this business, he needed to produce what he called 'demos' to convince film making companies to engage his services. Thus he needed to invest and incur start up expenses such as decoration, entertainment, demo tapes etc. It is possible that some or all of these expenses are separate from the Contract or the work for Company A. So the business registration is not conclusive. We must base our decision on the Contract and the circumstances relating thereto.

22. Is the Contract a contract of employment between Company A and the Taxpayer? Does it have the usual indicia of such relationship, bearing in mind that no single test is decisive?

23. It is not a fixed term contract. Although it mentions a period of 2 years, clause 3 means that it can be for a longer period. Yet the remuneration stops at the end of the two years. On the other hand, if the 4 films were completed before the two year period, the Taxpayer is released from his obligations earlier. Since time is money, a longer period of engagement is less advantageous than a shorter period and in this respect, the Taxpayer runs a financial risk.

24. Clause 9 which provides that Company A may transfer the benefit of the Contract to third parties with the consent of XXX is seldom found in contracts of employment, which by nature are personal contracts. The Taxpayer says that in fact none of the 4 films he took part in under the Contract were produced by Company A. The Contract was transferred under this clause. It is not clear if the Company A's rights could be transferred to more than one third party at a time. If Company A is the master or the employer, XXX can theoretically have as many as 4 masters at the same time.

25. The corollary is whether the Taxpayer needs to perform his service personally or whether he can do so through his assistants and employees. Having signed the Contract, albeit as the sole proprietor of a business, the Taxpayer is in law personally liable on the Contract and retains overall responsibility. However for reasons we stated earlier, the Contract does not provide for the Taxpayer's personal presence. XXX may be present and may carry out his obligations through an assistant or an employee. Mr Tam for the Commissioner suggested we should not believe the Taxpayer's evidence as to the hiring of

## INLAND REVENUE BOARD OF REVIEW DECISIONS

the three assistants. We note that the Revenue has had the details of the three assistants for some time. There is no evidence to contradict the Taxpayer's evidence on oath. Further the Taxpayer has produced the relevant salary receipts. We accept his evidence that these assistants were employed by his film production business and that they did work on the 4 films under the Contract. In his letter dated 14 April 1995, the Taxpayer said that most of the production managers earned \$60,000 to \$70,000 per film. Under the Contract, his business was paid more than \$150,000 per film. In evidence, he also said that Company A engaged less than the usual production managers during the period of the Contract. These are indicators that the Contract is one for services and that the Taxpayer was expected to hire his own employees or assistants for such services.

26. The evidence as to equipments is not entirely satisfactory. We note that the profits tax return claims some \$73,797.70 for supplies, props and set dressing. Yet when asked, the Taxpayer can only refer to the computer programme, the video camera and instant cameras. The mobile phone was purchased after the subject year of assessment. However it is not for us to go into the profit tax return in detail. In the written response to the Commissioner, Company A said it was possible for the Taxpayer to use his own equipment and facilities. Whether or not the video camera was sophisticated or common, it was used by the Taxpayer in the search for location for the Contract. Whether or not the computer programme was required under the Contract, the Taxpayer did invest in it and Company A enjoyed the benefit of such services. Thus the Taxpayer did invest and incur capital expenditure. For contracts requiring skill and experience more than equipment, the relatively minor amounts incurred on equipments is a sufficient indication that this is a contract for services.

27. The method of payment includes a deposit which is unusual for a contract of service. Mr Tam argues that the other payments are similar to monthly salaries. The Taxpayer argues that they are payments by instalment. In our view, they are more indicative of payment by instalments. They are described as instalments. They stop at the end of two years, yet under clause 3 work may continue at the end of the two year period.

28. Clause 6 is not a very strong indication either way. According to the profit tax return, during the subject year of assessment, the Taxpayer received \$34,000 from third parties under other contracts. If such amounts had been substantial, this would have been some indication that the Taxpayer was carrying on a business (see Hall v Lorimer [1994] 1 WLR 209 where the taxpayer customarily worked for 20 or more production companies on single day assignments). However in view of the relatively small amount, we cannot draw any conclusion therefrom.

29. We have carefully considered each and every one of the clauses in the Contract as well as all the factors urged upon us orally and in writing during the hearing. We find that in the circumstances of this case, the clauses or factors other than those we have specifically mentioned are not sufficiently indicative either way.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

30. At the end of the day, bearing in mind the contrast between a servant and an independent contractor, we are of the view that the Contract is one for services rather than of service, and the Taxpayer should be charged for profits rather than salaries tax.

31. For reasons given above, we allow the appeal.