Case No. D6/04

Salaries tax – whether income derived from Hong Kong from a source of employment – sections 8(1), 8(1A) and 8(1B) of the Inland Revenue Ordinance ('IRO').

Panel: Ronny Wong Fook Hum SC (chairman), Robert Law Chi Lim and Winnie Lun Pong Hing.

Date of hearing: 3 February 2004.
Date of decision: 12 May 2004.

Company A was the holding company of Company D and Company E. All three companies were incorporated in Hong Kong. By letter dated 25 April 2000 (the April Letter) on the letterhead of Company A, the appellant's employment by Group B in the capacity of 'Group Financial Controller – PRC' was confirmed. By a notification dated 17 April 2001, Company D reported to the Revenue the earnings of the appellant for the period between 25 April 2000 and 30 November 2000 (the First Period).

By a notification dated 18 January 2001, Company E informed the Revenue that the appellant was employed as 'Internal Audit Manager' for the period between 11 December 2000 and 18 January 2001 (the Second Period).

The appellant told the Revenue that he was stationed in City G, PRC during the First Period and he rendered his services as group financial controller to Companies J, K and L. He was also stationed in City G during the Second Period and he rendered his services as internal audit manager to Company E's group companies in PRC. He paid income tax in PRC but had not kept copies of the receipts.

By letter dated 29 December 2000 (the December Letter), Company M offered the appellant employment as 'Vice President, Finance' effective from 1 February 2001. The December Letter made it clear that the appellant's 'place of work will be in Hong Kong'. The appellant maintained that as from 1 November 2001 (the Third Period) he was permanently relocated to work in Company N in City O of PRC and since then he had not rendered any service in Hong Kong.

Held:

1. The question that the Board has to consider is this: Is the income derived from Hong Kong from a source of employment or is it not? In determining this question, the Board has to consider where the source of income, the employment, is located and not the locality where the services of the employee are actually rendered. The Board must have regard to the contract of employment between the parties. Once income is caught by section 8(1) of the IRO, there is no provision for apportionment and it is a misconception that the income so caught is not assessable to tax for the period during which the employee renders services outside Hong Kong. The April Letter was the only governing contract in force throughout the First and Second Periods. The Board rejects the appellant's contention that he did not render any services in Hong Kong during these two periods. The appellant had not produced any evidence in support of his bare assertion that he paid income tax in China. In the absence of any concrete proof, the Board rejects his claim for exemption under section 8(1A)(c) of the IRO.

2. In respect of the Third Period, the Board has no doubt that the appellant had not concluded any oral contract with Company N that superseded the December Letter. There is no concrete proof indicating payment of income tax in PRC. The exemption under section 8(1A)(c) is likewise unavailable to the appellant.

Appeal dismissed.

Wong Kai Cheong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Background in relation to the Appellant's employment between April 2000 and January 2001

1. By letter dated 25 April 2000 on the letterhead of Company A and signed by the managing director of that company ['the April Letter'], the Appellant's employment by 'Group B' in the capacity of 'Group Financial Controller – PRC' was confirmed. The April Letter further stated that:

> ' Your total remuneration will be HK$560,000 per annual (sic) or may be more as defined herewith. Your salary will be paid in both Hong Kong and PRC at a monthly total of HK$40,000 plus one month so called double pay and an annual bonus of not less than HK$40,000 payable before the Lunar New Year'.

2. Company A subsequently changed its name to Company C. It is the holding company of the following subsidiaries:

(a) Company D and

(b) Company E.

Company C, Company D and Company E are all companies incorporated in Hong Kong. At the material times, they carried on business in Hong Kong.

3. By a notification dated 17 April 2001, Company D reported to the Revenue the earnings of the Appellant as 'Group Financial Controller – PRC' for the period between 25 April 2000 and 30 November 2000 ['the First Period'] at $260,000.

4. In response to the assessor's enquires, Company D provided the following information in relation to the Appellants employment during the First Period:

(a) The April Letter was signed by the managing director of Company C in Hong Kong on 25 April 2000.

(b) During the First Period, the Appellant worked as group financial controller in Company F in City G of PRC. Company F is another subsidiary of Company C.

(c) During the First Period, the Appellant had to 'report to the General Manager of the group from time to time'.

(d) A total of $40,000 was paid to the Appellant each month. $36,000 was paid by Company D through bank autopay into the Appellant's bank account in Hong Kong. The balance of $4,000 was paid by Company F in City G.

(e) The amount of $260,000 reported in the notification referred to in paragraph 3 above was arrived at as follows:

Month	**Salary**
April 2000	$8,000
May 2000	$36,000
June 2000	$36,000
July 2000	$36,000
August 2000	$36,000
September 2000	$36,000

October 2000	$36,000
November 2000	$36,000
Total	$260,000

(f) He was transferred to Company E on 1 December 2000 and his bonus for 2000 was paid by Company E.

(g) The Appellant had paid China Individual Income Tax in respect of his income received from Company F. All copies of tax receipts and tax returns covering the First Period had been passed to the Appellant and Company D had no record of these documents.

5. By a notification dated 18 January 2001, Company E gave notice to the Revenue of the expected cessation of the Appellant's employment on 18 January 2001. Company E further informed the Revenue that the Appellant was employed as 'Internal Audit Manager' for the period between 11 December 2000 and 18 January 2001 ['the Second Period'] and his salary and bonus for that period amounted in total to $101,835.

6. In response to the assessor's enquiries, Company E provided the following information in relation to the Appellant's employment during the Second Period:

(a) There was no written employment contract or secondment letter between Company E and the Appellant.

(b) The Appellant was employed as 'Internal Audit Manager for [City G], PRC Operations' during the Second Period.

(c) The Appellant worked in Company H in City G. Company H is a subsidiary of Company E.

(d) The Appellant was stationed in City G 'permanently and was not required to render any service to our Company in Hong Kong except attending business meetings'.

(e) The exact amount of remuneration during the Second Period was in fact $114,563 computed as follows:

Month	**Salary**	**Bonus**	**Leave Pay**	**Total**
December 2000	$40,000			$40,000
January 2001	$42,857	$31,048	$658	$74,563
				$114,563

7. In his correspondence with the Revenue, the Appellant maintained that:

(a) The April Letter was signed on 25 April 2000, with Company C as its group financial controller in PRC.

(b) He was stationed in City G during the First Period and he rendered his services as group financial controller to three companies:

(i) Company J;

(ii) Company K and

(iii) Company L

(c) On 11 December 2000, he was re-designated as internal audit manager in PRC with Company E 'and the terms and conditions basically remained unchanged'.

(d) He was also stationed in City G during the Second Period and he rendered his services as internal audit manager to Company E's group companies in PRC.

(e) The purpose of his stay in Hong Kong during the First and Second Periods 'was mainly for week-end off and annual leave'.

(f) '... Exemption under Section 8(1A)(b)(ii) is applicable to my case based on the ground that the attending meetings were wholly for the business of the companies in the PRC and reported duties were in the capacity as an employee of the companies in the PRC. All these constituted a kind of service rendered to the companies in the PRC and NOT my companies'.

(g) He paid income tax in PRC but had not kept copies of the receipts.

Background in relation to the Appellant's employment as from 1 February 2001

8. By letter dated 29 December 2000 ['the December Letter'], Company M offered the Appellant employment as 'Vice President, Finance reporting to the President/CEO of the Company, effective from February 1st 2001'. The December Letter made it clear that:

(a) the Appellant's 'place of work will be in Hong Kong'.

(b) Company M 'reserves the right to reassign [the Appellant] in the future to another post in accordance to your experience and capacity, within the organization of [Company M]' (Clause 9).

9. The Appellant maintained that as from 1 November 2001 ['the Third Period'] he was permanently relocated to work in Company N in City O of PRC and since then he had not rendered any service in Hong Kong.

10. In response to the assessor's inquiries, Company M provided the following information:

(a) The Appellant had not been permanently relocated to work in City O and 'he is still under the Hong Kong employment with our Company ...'.

(b) As from November 2001 onwards, the Appellant was requested to travel daily to China and to work in City O.

(c) From November 20001 onwards, the Appellant was also 'rendering service to our Company in Hong Kong including meetings, entertaining Company's clients'.

The issues

11. The issue before us is whether the Appellant is liable for salaries tax in respect of his earnings during the First, Second and Third Periods.

The law

12. The charge under section 8(1) of the Inland Revenue Ordinance ['IRO'] is against 'income arising in or derived from Hong Kong' from any office or employment of profit. The question that we have to consider is this: Is the income derived from Hong Kong from a source of employment or is it not? In determining this question, we have to consider where the source of income, the employment, is located and not the locality where the services of the employee are actually rendered. We have to look for the place where the income really comes to the employee and in this connection we must have regard to the contract of employment between the parties. Once income is caught by section 8(1) of the IRO, there is no provision for apportionment and it is a misconception that the income so caught is not assessable to tax for the period during which the employee renders services outside Hong Kong.

13. By virtue of section 8(1A)(b) of the IRO, income arising in or derived from Hong Kong from any employment excludes income derived from services rendered by a person who renders outside Hong Kong all the services in connection with his employment. Section 8(1B) of

the IRO further provides that in determining whether or not all services are rendered outside Hong Kong, no account shall be taken of services rendered in Hong Kong during visits not exceeding a total of 60 days in the basis period for the year of assessment.

14. By virtue of section 8(1A)(c) income arising in or derived from Hong Kong excludes income derived by a person from services rendered by him in any territory outside Hong Kong where 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 the IRO and the Commissioner is satisfied that that person has paid tax of that nature in that territory in respect of the income.

The oral testimony of the Appellant

15. The following are the salient points of the Appellant's sworn testimony:

(a) In relation to the First and Second Periods:

(i) He cannot recall whether the April Letter was handed to him personally in Hong Kong or in China. He reported for duties in Hong Kong on 25 April 2000 and a colleague accompanied him to China.

(ii) He does not know why Company D submitted to the Revenue the 17 April 2001 notification. He did pay tax on the $4,000 paid by Company F. He did not have any written agreement with Company F.

(iii) After his engagement as China controller pursuant to the April Letter, he rendered all his services in China except he did return to Hong Kong to report to one of his superiors stationed in Hong Kong. He did not regard such reporting as amounting to providing services in Hong Kong.

(b) In relation to the Third Period:

(i) Commencing from November 2001, he was asked by Mr P, President/CEO of Company M to report to Company N. His 'boss' was then stationed in City O and Ms Q was the only employee of Company M left in Hong Kong. He did not have to report to Ms Q. This was a 're-location' pursuant to a new contract and not a 'reassignment' pursuant to clause 9 of the December Letter.

(ii) The Appellant was confronted by various 'Expense Report' of Company M wherein the Appellant claimed travel expenses for 'visiting factory in [City O]' and for 'work in [City O] Office'. He explained that he was not provided with any accommodation as a result of his

re-location. He was therefore paid for his journeys between Hong Kong and City O.

Our decision

16. In respect of the First and the Second Periods:

(a) We are of the view that the source of the Appellant's income, the employment, is located in Hong Kong and not in China. The April Letter was the only governing contract in force throughout both periods. It was a letter from the holding company of the entire Group B and signed in Hong Kong by its managing director. It confirmed the Appellant's engagement by the 'Group B'. We find that such reference was for the convenience of Company A reserving thereby the right to designate the ultimate employer. Company D and Company E were the two entities who eventually submitted returns in respect of the Appellant's earnings. They are Hong Kong companies within the then 'Group B'. The Appellant was paid both in Hong Kong and in the PRC for the total sum of $40,000 per month. That was in accordance with the express provision in the April Letter. There is no evidence to suggest that the Appellant had entered into any other contract with any PRC entity. We therefore find that the source of the Appellant's income is located in Hong Kong and his entire income at $40,000 is within section 8(1) of the IRO.

(b) We reject the Appellant's contention that he did not render any services in Hong Kong during these two periods. Given our finding that there was no contract of employment subsisting between the Appellant and any PRC entity, his reporting 'to the General Manager of the group from time to time' must have been pursuant to his obligations under the April Letter. The Appellant is therefore not entitled to any exemption under section 8(1A)(b) of the IRO.

(c) The Appellant had not produced any evidence in support of his bare assertion that he paid income tax in China. In the absence of any concrete proof, we reject his claim for exemption under section 8(1A)(c) of the IRO.

17. In respect of the Third Period:

(a) We have no doubt that the Appellant had not concluded any oral contract with Company N that superseded the December Letter. We accept the intimation from Company M that the Appellant was 'still under the Hong Kong employment with our Company'. We reject the Appellant's explanation in relation to reimbursements from Company M for his travel expenses between Hong Kong and City O. Such reimbursements serve to confirm the continued

subsistence of the contractual relationship between the Plaintiff and that company.

(b) The Appellant did not render all his services in PRC. There was no serious challenge by the Appellant of the intimation from Company M that he rendered services to that company including meetings and entertaining clients. The exemption under section 8(1A)(b) of the IRO is not available to the Appellant.

(c) There is no concrete proof indicating payment of income tax in PRC. The exemption under section 8(1A)(c) is likewise unavailable to the Appellant.

18. For these reasons, we dismiss the Appellant's appeal and confirm the assessments.