Case No. D67/01

Salaries tax – section 8(1) of the Inland Revenue Ordinance ('IRO') – two-contract arrangement – whether an employment income arose in or was derived from Hong Kong – section 61A of the IRO – whether the Board a proper forum to consider the refusal to accept late objection – section 9(1)(d) of the IRO – whether the exercise of share option is liable to tax.

Panel: Anna Chow Suk Han (chairman), Christopher Henry Sherrin and Michael Neale Somerville.

Date of hearing: 8 June 2000.
Date of decision: 20 August 2001.

The taxpayer was employed by Company B, which was incorporated in Hong Kong. The taxpayer also received income from Company K, which was incorporated in Country f. Company B filed employer's returns for the years of assessment including the taxpayer's income paid by Company K and also informed the assessor that the taxpayer exercised options to acquire shares in Company G on 10 December 1993 and realized gains.

In the taxpayer's return, the taxpayer did not declare the income received from Company K or the gains realized by him on exercise of share options. The assessor raised additional salaries tax assessments on matters that the taxpayer's failure to inform. The taxpayer objected to the assessor's refusal to correct the assessment and the additional assessments.

The taxpayer argued that section 61A of the IRO was not invoked at the assessment stage and argued that the Acting Commissioner had no authority to invoke that section at the determination stage. Furthermore, it is the taxpayer's case that there were two contracts of employment, one within Hong Kong for the works for Company B and the other outside Hong Kong for the works for Company K.

It is the Respondent's case that the alleged employment with Company K was a transaction entered into for the purpose of reducing the salaries tax liability and thus should be disregarded under section 61 of the IRO.

Held:

1. The Acting Commissioner had authority to invoke section 61A at the determination stage. In considering an objection to an assessment, the Commissioner does not act

judicially but administratively, putting himself in the shoes of the assessor and determining what, according to his view, the assessment ought to be. By adopting a more liberal interpretation of section 61A(2), the interests of the taxpayer had not been compromised. The taxpayer had his opportunity to make representations on the applicability of section 61A to his case and if he felt aggrieved by the Commissioner's decision to invoke section 61A, a right of appeal to this Board was still available to him (D41/91 applied).

2. Section 18(1)(a) of the IRO is the basic charging section for salaries tax which provides that salaries tax shall be charged on every person in respect of his income arising in or derived from Hong Kong from any office or employment. The expression 'income arising in or derived from Hong Kong' in section 8(1)(a) is referable to the locality of the source of income and not the place where the duties of the employee are performed. The place where the services are rendered is not relevant to the enquiry under section 8(1) as to whether income arises in or is derived from Hong Kong from any employment and should be ignored (CIR v Geopfert followed).

3. Thus if during the relevant years of assessment, the taxpayer had only one employment and the location of his employment was Hong Kong, he would be liable to salaries tax on the whole of income from this employment under section 8(1)(a) although he was required to perform some of his duties outside Hong Kong in connection with his employment. Also, there is no provision for apportionment in such case.

4. Having considered the evidence, the Board is of the view that there was in reality only one employment and the source was from Hong Kong. The Board also finds that the taxpayer's employment with Company K was an artificial transaction within the meaning of section 61 of the IRO (CIR v Geopfert followed).

5. The Board is not the proper forum to consider whether the Commissioner is correct in refusing to accept the late objection lodged by the taxpayer. The proper course of action would be an application for a judicial review.

6. According to section 9(1)(d) of the IRO, a person would be assessed on the gain realized by him by the exercise of a right to acquire shares. It is the exercise of the option obtained rather than the mere grant of the option which gives rise to tax liability. In view of the Board's finding that the taxpayer's employment was in Hong Kong, the gain from the exercise of the share option is therefore liable to tax.

Appeal dismissed.

Cases referred to:

FCT v Spotless Services Limited (1997) 34 ATR 183
Mullens v FCT (1976) 76 ATC 4288
FCT v Peabody (1984) 84 ATC 4663
Europa Oil (NZ) Limited v Commissioner of Inland Revenue (No 2) [1976] 1 WLR 464
Commissioner of Inland Revenue v Challenge Corporation Ltd [1987] AC 155
WD & HO Wills (Australia) Pty Ltd v FCT
D44/92, IRBRD, vol 7, 324
D67/95, IRBRD, vol 11, 44
D52/96, IRBRD, vol 11, 554
Henricksen (HM Inspector of Taxes) v Grafton Hotel Ltd (1942) 24 TC 453
Jackson (HM Inspector of Taxes) v Laskers Home Furnishers Ltd (1956) 37 TC 69
CIR v Loganathan Suresh Babu [Inland Revenue Appeal No 3 of 1999]
Mok Tsze Fung v CIR 1 HKTC 166
CIR v The Hong Kong Bottlers Limited 1 HKTC 497
D39/97, IRBRD, vol 12, 276
D41/91, IRBRD, vol 6, 211
CIR v Howe [1977] 2 HKTC 936
CIR v Goepfert [1987] 2 HKTC 210
Foulsham v Pickles 9 TC 261
Bennet v Marshall 22 TC 73
Bray v Colenbrander 34 TC 138
Seramco Ltd Superannuation Fund v ITC [1977] AC 287
Snook v London and West Riding Investment Ltd [1967] 2 QB 786
Kum Hing Land Investment Co Ltd v Commissioner of Inland Revenue (1967) 1 HKTC 301
D52/86, IRBRD, vol 2, 314
The Queen v Alberta and Southern Gas Co Ltd (1977) 77 DTC 5244
CEC v Comptroller of Income Tax [1971] SLR Lexis 68
D18/98, IRBRD, vol 13, 180
D79/97, IRBRD, vol 12, 461
D69/98, IRBRD, vol 13, 412
Chun Yuet Bun Trading as Chong Hing Electrical Co v CIR 2 HKTC 325

Ng Yuk Chun for the Commissioner of Inland Revenue.
Neil Thomson instructed by Messrs Horvath & Giles for the taxpayer.

Decision:

The appeal

1. Mr A (' the Taxpayer') has objected to the assessor' s refusal to correct the salaries tax assessment for the year of assessment 1993/94 raised on him. He has also objected to the salaries tax assessments for the years of assessment 1994/95 and 1996/97 as well as the additional salaries tax assessments for the years of assessment 1993/94, 1996/97 and 1997/98. The Taxpayer claims that there is an error in a return filed by his employer and that certain income and benefits received by him are not chargeable to salaries tax. By a determination dated 14 December 1999 (' the Determination'), Acting Commissioner of Inland Revenue confirmed the said assessments. The Taxpayer is now appealing against the Determination.

The preliminary issue

2. The Taxpayer had taken issue with the fact that section 61A of the IRO was not invoked at the assessment stage and argued that the Acting Commissioner had no authority to invoke that section at the determination stage. The Taxpayer argued that by virtue of section 61A(2) of the IRO the assessments should have been raised by an assistant commissioner.

3. Section 61A(2) provides:

> *' Where subsection (1) applies, the powers conferred upon an assessor under Part X shall be exercised by an assistant commissioner, and...'*

4. Counsel for the Taxpayer asserted that there was no equivalent of section 3A of the IRO which enabled the powers and duties conferred on the Commissioner to be exercised by an assistant or deputy commissioner; the principle of ' delegatus non protest delegare' should apply; and a review by the Commissioner when making a determination did not obviate the need to make an assessment under section 61A nor did it legitimize or transmute the assessor' s assessment into one made by the Assistant Commissioner under section 61A(2). In support of this contention, Counsel referred us to the following authorities:

> Departmental Interpretation and Practice Notes No 15 (Revised)
> FCT v Spotless Services Limited (1997) 34 ATR 83
> Mullens v FCT (1976) 76 ATC 4288
> FCT v Peabody (1984) 84 ATC 4663
> Europa Oil (NZ) Limited v Commissioner of Inland Revenue (No 2) [1976] 1 WLR 464

Commissioner of Inland Revenue v Challenge Corporation Ltd [1987] AC 155
WD & HO Wills (Australia) Pty Ltd v FCT
D44/92, IRBRD, vol 7, 324
D67/95, IRBRD, vol 11, 44
D52/96, IRBRD, vol 11, 554
Henricksen (HM Inspector of Taxes) v Grafton Hotel Ltd (1942) 24 TC 453
Jackson (HM Inspector of Taxes) v Laskers Home Furnishers Ltd (1956) 37 TC 69

5. The following authorities were cited to us by the Respondent in support of its contention that upon a proper interpretation of section 61A(2) the Commissioner was entitled to invoke section 61A, the anti-avoidance provision, at the determination stage even though it was not invoked by an Assistant Commissioner at the assessment stage.

CIR v Loganathan Suresh Babu [Inland Revenue Appeal No 3 of 1999]
Mok Tsze Fung v CIR 1 HKTC 166
CIR v The Hong Kong Bottlers Limited 1 HKTC 497
D39/97, IRBRD, vol 12, 276
D41/91, IRBRD, vol 6, 211

6. It was also submitted by the Respondent that section 61A was an alternative argument for the Commissioner and that if the Board found that section 61 was applicable to the present case, it would not be necessary for this Board to consider section 61A at all. However, it was submitted that if this Board found that the Commissioner had no authority to invoke section 61A, the Board could still invoke section 61A if considered appropriate and necessary.

7. Having carefully considered the authorities cited to us and the submissions made by both parties, we are of the view that the Acting Commissioner had authority to invoke section 61A at the determination stage. We agree with the views expressed in the authorities cited that ' in considering an objection to an assessment, the Commissioner does not act judicially but administratively, putting himself in the shoes of the assessor and determining what according to his view, the assessment ought to be' . In reaching our view, we also derive assistance from the following passage from D41/91:

> '*It is perhaps worth emphasizing that the discretion to "disregard" a transaction is vested in the first place under section 61 in the assessor. Assume that in a particular case an assessor had never applied section 61: is the Commissioner, in entertaining an objection under section 64 of the Inland Revenue Ordinance, entitled to apply it for the first time? The answer is yes: see CIR v Howe [1977] 2 HKTC 936 at 955. The Commissioner's task is to review the assessment and he has the power under section 64(2) to increase the assessment. But one would expect the Commissioner to be extremely slow in exercising this power in the*

> *circumstances where the assessor had never invoked section 61, and before doing so would afford the Appellant ample opportunity to make representations, and bring forward facts, to show why the section should not be invoked in this way.'*

We believe the same can be said about section 61A. Further, we agree with the Respondent that by adopting a more liberal interpretation of section 61A(2), the interests of the Taxpayer had not been compromised. The Taxpayer had his opportunity to make representations on the applicability of section 61A to his case and if he felt aggrieved by the Commissioner's decision to invoke section 61A, a right of appeal to this Board was still available to him.

The agreed facts

8. Pursuant to an appointment letter dated 16 January 1987, the Taxpayer was employed as marketing manager Asia/Pacific by Company B-Hong Kong (formerly known as Company C-Hong Kong, Company D-Hong Kong, Company E-Hong Kong and Company F-Hong Kong), which is hereinafter referred to as 'Company B-HK'.

9. The post of marketing manager Asia/Pacific required travel outside Hong Kong.

10. In May 1988, the Taxpayer was transferred to Company B-Asia Pacific (formerly known as Company G-Asia Pacific, Company D-Asia Pacific, Company E-Asia Pacific and Company F-Asia Pacific), which is hereinafter referred to as 'Company B-AP'.

11. In August 1988 the Taxpayer took up the position of Company B representative-Country j/Country k and was relocated to work in Country j.

12. On 12 March 1990 the Taxpayer was transferred back to Hong Kong to take up the post of product marketing manager ('PMM').

13. By a memorandum dated 16 March 1990 issued by a PMM to the Taxpayer, the Taxpayer's terms of appointment as PMM were confirmed and included the following:

(a) Base salary: US$90,000 per annum paid monthly in twelve equal instalments
(b) Housing allowance: HK$19,500 per month
(c) Bonus: US$45,000 per annum

A copy of the memorandum was submitted by Company B-AP to the Immigration Department in support of the application for an employment visa for the Taxpayer.

14. By letter dated 25 July 1990 to the Immigration Department, Company B-AP confirmed that the Taxpayer was its employee and that his job required regular international travel.

15. Company B-HK was incorporated as a private company in Hong Kong on 8 July 1983 and carried on business in Hong Kong. At all relevant times, it was a fellow subsidiary of Company B-AP.

16. (a) Company B-AP as incorporated as a private company in Hong Kong on 8 July 1986 and carried on business in Hong Kong. At all material times, the ultimate holding company of Company B-AP was Company G, a company incorporated in Country a. Company B-AP described its activities as follows:

> ' The company provides management services for its affiliated companies in the Asia Pacific Region and distributes the Company G computerized financial information network in Country b and Country c under a distribution agreement with Company F-International. The network provides dynamically updated financial market data through video terminals located at subscribers' premises.'

(b) Company B-AP had regional responsibilities for Asia Pacific. This office was the regional service centre for the network of Company F companies in the Asia Pacific region. The main categories of employees employed in this office were:

Regional executive management
Regional marketing staff
Regional finance staff
Regional human resources staff
Regional technical development staff

(c) The following persons were, among others, directors of Company B-AP during the periods shown below:

Name	**Period of directorship**
Mr H	11-10-86 – 1-10-91
Mr I	21-12-89 – 4-3-98
Mr J	25-6-90 – 1-10-96
The Taxpayer	28-1-92 – 2-6-98

17. Company K was incorporated in 1988 in the Islands d of Country f. At all material times, Company K was a subsidiary of Company G.

18. (a) Company B-AP filed employer's returns for the years of assessment 1993/94 to 1997/98 in respect of the Taxpayer, which showed, among others, the following income particulars:

		1993/94	1994/95	1995/96	1996/97	1997/98
		$	$	$	$	$
(i)	Income from Company B-AP					
	Salary/wage	726,277	612,806	801,667	946,856	1,115,573
	Bonus	102,506	110,657	89,166	-	-
	Others	173,223	93,600	93,600	102,492	121,815
	Total	1,002,006	817,063	984,433	1,049,348	1,237,388
(ii)	Income paid by Company K (US$)	96,794	112,237	120,346	64,204	131,699
	HK$ equivalent	747,317	866,177	929,179	495,680	1,016,597

Company B-AP fully refunded to the Taxpayer the rent paid by him for his residence in Hong Kong.

(b) Company B-AP also informed the assessor that the Taxpayer exercised options to acquire shares in Company G on 10 December 1993 and realized therefrom gains totalling US$102,801.25 (equivalent to HK$793,697), with particulars shown below:

	Date of grant of share option	Number of shares acquired	Gain on exercise of share option US$
(i)	21-2-1990	2,000	19,250.00
(ii)	19-2-1991	3,190	37,482.50
(iii)	19-2-1992	3,200	15,600.00
(iv)	18-11-1992	3,250	30,468.75
			102,801.25

19. In his returns for the years of assessment 1993/94 to 1997/98, the Taxpayer declared the same income and benefits derived by him from Company B-AP as per paragraph 18(a)(i). He did not declare the income received by him from Company K per paragraph 18(a)(ii) or the gains realized by him on exercise of share options referred to in paragraph 18(b).

20. On divers dates the assessor raised on the Taxpayer the following salaries tax assessments and additional salaries tax assessments for the years of assessment 1993/94 to 1997/98:

(a) Salaries tax assessments

	1993/94	**1994/95**	**1995/96**	**1996/97**	**1997/98**
	$	**$**	**$**	**$**	**$**
Income from Company B-AP per paragraph 18(a)(i)	1,002,006	817,063	984,433	1,049,348	1,237,388
Income from Company K per paragraph 18(a)(ii)	747,317	866,177	929,179	-	-
	1,749,323	1,683,240	1,913,612	1,049,348	1,237,388
Value of quarters	174,932	168,324	191,361	104,934	123,738
Total income	1,924,255	1,851,564	2,104,973	1,154,282	1,361,126
Less: Charitable donations	-	-	-	-	84,000
Net assessable income	1,924,255	1,851,564	2,104,973	1,154,282	1,277,126
Tax payable thereon	288,638	277,734	315,745	173,142	191,568

(b) Additional salaries tax assessments

	1993/94	**1996/97**	**1997/98**
	$	**$**	**$**
Income before value of quarters per (a) above	1,749,323	1,049,348	1,237,388
Gains on exercise of share options per paragraph 18(b)	793,697	-	-
Income from Company K per paragraph 18(a)(ii)	-	495,680	1,016,597
	2,543,020	1,545,028	2,253,985

Value of quarters	254,302	154,502	225,398
Total income	2,797,322	1,699,530	2,479,383
Less: Charitable donations	-	-	84,000
Net assessable income	2,797,322	1,699,530	2,395,383
Less: Income already assessed per (a) above	1,924,255	1,154,282	1,277,126
Additional assessable income	873,067	545,248	1,118,257
Additional tax payable thereon	130,960	81,787	150,965

21. (a) Messrs Coopers & Lybrand (' the Representatives'), on behalf of the Taxpayer, lodged an application under section 70A of the IRO to correct the salaries tax assessment for the year of assessment 1993/94 in the following terms:

> ' ... the employer' s return (Form IR56B) for the year ended 31.3.1994 which has been filed by [Company B-AP] has erroneously included [the Taxpayer' s] overseas income (US$96,794) earned from [Company K] which should not be chargeable to salaries tax. All his services for Company K are preformed outside Hong Kong and are solely for business of Company K in the Asia Pacific region which includes countries like Countries b, e, f, g, h, i, j and k. In addition, your office has made an arithmetical error in computing the assessable income on the notice of assessment as the amount is not in accordance with the salaries tax return by [the Taxpayer].'

(b) The assessor was not satisfied that there was any error or omission in the return or statement for the year of assessment 1993/94. He refused to correct the assessment for the year of assessment 1993/94 under section 70A of the IRO.

22. The Taxpayer objected against the assessor' s refusal to correct the assessment for the year of assessment 1993/94. He also objected against the assessments for the years of assessment 1994/95 and 1996/97 as well as the additional assessments for the years of assessment 1996/97 and 1997/98 in similar terms set out in paragraph 21(a) above.

23. The Taxpayer objected against the additional salaries tax assessment for the year of assessment 1993/94 in the following terms:

> ' ... the 2,000 shares of stock options exercised on 10.12.1993 were granted to [the Taxpayer] prior to his assignment in Hong Kong. Therefore, the stock option benefits of US$19,250 should entirely be exempted from salaries tax...' and ' a portion of the

stock options granted to [the Taxpayer] were related to his services rendered outside Hong Kong for his employment with Company K.'

24. The Taxpayer also objected against the salaries tax assessment for the year of assessment 1995/96. But the notice of objection was not filed within the time stipulated in section 64 of the IRO and hence was rejected by the assessor.

Findings of additional facts

25. Based on the documents and oral evidence before us, we find the following additional facts.

26. Under the letter of appointment dated 16 January 1987 referred to in paragraph 8 above, the Taxpayer became eligible for the executive pension plan upon successful completion of the probationary period of three months.

27. The PMM who issued the memorandum dated 16 March 1990 referred to in paragraph 13 above was Mr I. Mr I was a director of Company B-AP.

28. Company K referred to above was formerly known as Company B-Pacific.

29. The job description (or the list of duties) of the position of regional sales and marketing manager, involved regular travel to the 13 countries of the region Asia Pacific as well as City l in Europe and City m in North America and required, among other things, a thorough understanding of the strategic requirements of the company.

30. By a letter dated 19 January 1990 issued by Company B-AP to the Taxpayer, the Taxpayer was promoted to the position of PMM with effect from 12 March 1990. The terms of the employment such as salary, bonus, housing allowance and other benefits were set out. It also provided that the continued employment beyond the term would be subject to continued and ongoing satisfactory performance and a review of the relative responsibilities and demands of the Taxpayer's position in Company K as marketing manager and that if Company K absorbed more (or less) of the Taxpayer's time, higher (or lower) of his total costs would be borne by Company K. By another letter also dated 19 January 1990 issued by Company K to the Taxpayer, the Taxpayer's promotion to the position of PMM with effect from 12 March 1990 was confirmed, with the duties to be performed in Countries b, e, f, g, h, j and k. However, those duties were not specified in the letter. All other benefits were said to be those usually and customarily provided to executives of the company. Both employments were for a period of at least six months but not longer than one year. Both letters were signed by Mr H whose position in the companies were not stated in the letters. The letters were sent to the Taxpayer at his address in Country j. The Company B-AP employment provided a salary of US$63,000 per annum and bonus of

US$31,500 per annum while the employment with Company K provided a salary of US$27,000 and a bonus of US$13,500 per annum.

31. The memorandum from the PMM to Mr A of 16 March 1990, confirmed the Taxpayer's appointment to the Asia Pacific regional office as PMM on 12 March 1990. Apart from the Taxpayer's salary of $90,000 per annum, bonus of $45,000 per annum and housing allowance of $19,500 per month, it set out the functions of his department which comprised regional product marketing, marketing strategy and corporate communications and responsibility for positioning and developing market opportunities for Company B's products.

32. The nonqualified stock option agreement dated 19 February 1992 in respect of the Taxpayer, provided that no part of the option might be exercised until the Taxpayer had remained in the employ of the company for a period of one year after the date of the agreement.

33. By two letters of 1994 compensation review both dated 13 April 1994 issued by Company B-AP and Company K respectively, the Taxpayer's salaries and bonus in both companies were accordingly revised effective from 1 January 1994. Both letters were signed by Mr J and received by the Taxpayer in Hong Kong. Mr J did not state the capacity in which he signed those letters.

34. It was stated in the letter of 8 May 1996 from Ms L on behalf of Company B-AP to the Inland Revenue Department ('IRD') that the Taxpayer had entered into separate employment with Company B-AP and Company K and that the Taxpayer was initially employed by Company K as PMM and was promoted to senior regional manager on 1 October 1991 and to deputy managing director on 1 January 1992. In his capacity of deputy managing director for Company K, the Taxpayer undertook general management duties relating to the operation of the business as well as contractual negotiations with third party suppliers and liasing with local partners for Company E-Holdings' offices in various countries in Asia Pacific region. All the work for Company K was undertaken outside Hong Kong. As deputy managing director of Company B-AP, the Taxpayer managed the Asia Pacific regional office of Company E, consisting of the company's operations, systems and product marketing, editorial, development and corporate communications departments. These works took place in Hong Kong. The share options were granted to the Taxpayer in his capacity as deputy managing director with Company K and Company B-AP.

35. It was stated in a letter from a Ms M of the Representatives to the IRD of 9 December 1996 that the Taxpayer was responsible for the marketing activities of Company B-AP in Hong Kong and Company K in the Asia Pacific countries excluding Hong Kong and as the Taxpayer was promoted to deputy managing director, his duties were to manage the operation of Company B-AP in Hong Kong and Company K in the Asia Pacific countries excluding Hong Kong.

36. Mr I for and on behalf of Company K stated in his letter to Ms L dated 31 January 1997 that the Taxpayer was employed by the company and paid in Country i to oversee all the sales

and marketing activities of Company B's products at Company G's subsidiary companies and distributors in the Asia/Pacific region which were located outside the country in which the area regional office was headquartered and that at that time the regional office was located in Hong Kong. He said that the Taxpayer's duties had not changed substantially since he was first employed and in some instances, for example, Country n, he had assumed roles akin to a country manager where he had direct operational management control. Much of his work was of a 'hands on' nature and involved many sale calls to clients and customers at the various locations. He also stated that Company K was a small company located in Islands d and that they did not feel the need to have an organization chart to carry out their work. Mr I was described as a director in the letter.

37. In reply to the assessor's queries by a letter of 6 May 1997, Ms L on behalf of Company B-AP responded that when the Taxpayer was transferred back to Hong Kong on 12 March 1990, his employment was considered as continuous but the nature of his duties changed and he took on several additional offices including the position of PMM for Company K.

38. By a letter of 10 December 1997, Ms L on behalf of Company B-AP informed the assessor that for his duties under Company K for the years ended 31 March 1991, 31 March 1994 and 31 March 1995, the Taxpayer was responsible to the senior corporate officers in Company G through the office of Company B-AP. At that time, it was Mr H who operated from Country a.

39. In her letter of 31 March 1998, Ms L informed the IRD that Company B-AP had regional responsibilities for Asia Pacific and all the employees of Company B-AP were engaged in duties to establish regional strategies and policies, formulate marketing plans, consolidate financial, budgetary and employee information for the 14 operating countries in Asia Pacific.

40. By a termination letter of 1 June 1998 on the letterhead of Company B-AP, the Taxpayer was informed that his position was made redundant as a result of the acquisition by Company N. It also referred to a payment in lieu of 60 days notice and other compensation as detailed in a discussion with a Mr O. The Taxpayer was also informed that he was required to sign a release agreement in order to receive the final payment.

41. The compensation payment received by the Taxpayer from Company B-AP included the payment in lieu of 60 days notice of Company K and the salary for April and May 1998 for Company K. It was confirmed by the human resources manager of Company B-AP that the said payment of Company K was booked as staff cost in the accounts of Company B-AP.

42. In reply to the assessor's queries, by a letter of 12 August 1997, the Representatives informed the assessor that Mr J was a director of Company K; Mr J's principal office was located in Hong Kong; Company K did not have an office or business presence in Hong Kong; and the human resources function in Hong Kong distributed salary advices for regional management and Company K sent all such advices in bulk for distribution by the department.

43. In the termination statement of 21 August 1998 in respect of the Taxpayer under Company F-Asia Pacific retirement scheme it was recorded that the Taxpayer joined the company on 2 February 1987 and the termination date of the employment was 1 June 1998 and the date for joining the scheme was 2 May 1987.

44. The Taxpayer produced a letter from a Mr P dated 2 June 2000. Mr P was working for Company G. He was an employee of Company B-AP between June 1990 and March 2000.

The salient points in the Taxpayer's evidence

45. The Taxpayer gave oral testimony to the following effects.

46. The Taxpayer commenced working for Company B-AP in February 1987 reporting to the then deputy managing director, Mr Q. He was transferred to Country j from March 1988 to March 1990. He reported to Mr H, managing director of Company B-AP who was in Hong Kong at that time. The Taxpayer negotiated the terms of the two contracts with Mr H in Country j. The contracts were sent to him for signing in Country j.

47. During the course of negotiation, they discussed the differentiation between the strategic role versus the tactical role, the reporting lines that the structure entailed and what tax efficiency in Hong Kong meant. The Taxpayer explained his role in Company B-AP was the day to day tactical issues of managing a company that had regional presence and the role in Company K was the strategic issues focusing on the third part alliance programmes. He reported to Mr R, the president of Company E, based in Country a and Mr H, the senior vice-president of Company E, on the strategic issues and to Mr J, the deputy managing director of Company B-AP, on the tactical issues. Mr H moved back to Country a shortly after the Taxpayer returned to Hong Kong.

48. Company K was independent of the Company B-AP's reporting line because the strategic nature of the negotiations involved a completely different team of people to those on the Company B-AP organizational chart. Most of the negotiating team came from Country a and the final decisions would be made by Mr R, the president of Company E, in Country a.

49. Company K was introduced to him by Mr H. Company K was a structure which was in place before the Taxpayer's involvement with the company. The Taxpayer was not involved in the design and structuring of the company nor was privy to the details of Company K as an organization.

50. He did not give a direct answer to the question of whether he would agree to the confirmation of Company B-AP that his relocation to County j did not constitute a break in his employment. But he agreed to the fact that he continued to participate in the executive pension fund operated by Company B-AP during the period of the assignment in Country j.

51. He said that the job description (or the list of duties) supplied by Ms L, the regional manager, referred to the post of regional sales and marketing manager which he held in Hong Kong in 1987.

52. The tax advantage indicated to him by the Representatives was that ' for services rendered offshore, there would not be tax responsibility in Hong Kong' .

53. He did not confirm that Company B-AP was the Asia Pacific regional office of Company G group. He only confirmed that Company B-AP had regional responsibilities consistent with tactical day to day operations and that Company K was playing a very active strategic role in the region.

54. He did not give a direct reply to the question of whether he had any explanation to his former representative' s distinction of function as to the locality of the market rather than strategic versus tactical issues. Instead, he referred us to Mr P' s letter, for the reporting lines therein mentioned.

55. He did not confirm Ms L' s statement that he reported to the personnel in Country a through the Hong Kong Office. He again referred us to Mr P' s letter.

56. He said that the organization structure and the title for Company K were more implicit than specific.

57. On the question of why his salary review letter was not signed by Mr R or Mr H since he was reporting to them, he replied that it was signed by Mr J presumably for expediency because Mr J was in Hong Kong.

58. In discharging the duties in Company K, there were preparatory and follow-up works in Hong Kong but the bulk of the preparation, negotiation and the final agreements were executed offshore.

59. He said that the accounting function was based in Hong Kong and Company K was a small organization that did not have that capacity. In computing the payment in lieu of notice, perhaps Company B-AP took Company K' s payment into account for sake of ease and convenience.

60. He did not sign a release agreement with Company K.

61. He considered that the confidentiality clause in the release agreement covered ' everything' , both Company B-AP and Company K.

62. He was promoted to a job with two main responsibilities. He would say that one employment agreement could not happen without the other or vice versa and in a way one employment agreement was dependent upon the other.

63. He had no knowledge as to which entity bore his salary or the costs of Company K activities. There could be an allocation by the accounts department. Mr I handled all of the financial responsibilities.

64. He was paid salary for April and May 1998 in the sum of US$12,000 by Company K despite his employment with Company K terminated in April 1998, because at that time negotiations were continuing with Company S in Country e up to the sale of Company F to Company N in May or June 1998.

65. For commercial reasons, the Taxpayer had only one business card which said ' Company F' .

Decision

66. The Taxpayer' s Counsel had cited the following authorities in support of the Taxpayer' s case:

Source

CIR v Goepfert 2 HKTC 210
Foulsham v Pickles 9 TC 261
Bennet v Marshall 22 TC 73
Bray v Colenbrander 34 TC 138

Section 61

Seramco Ltd Superannuation Fund v ITC [1977] AC 287
Snook v London and West Riding Investments Ltd [1967] 2 QB 786
Kum Hing Land Investment Co Ltd v Commissioner of Inland Revenue (1967) 1 HKTC 301
Commissioner of Inland Regenue v Howe (1977) 1 HKTC 936
D52/86, IRBRD, vol 2, 314
The Queen v Alberta and Southern Gas Co Ltd (1977) 77 DTC 5244; 1977 Con F C Lexis 391
CEC v Comptroller of Income Tax [1971] SLR Lexis 68, 1969-1971 SLR 466

67. The Respondent had cited the following authorities in support of its case:

D18/98, IRBRD, vol 13, 180
D79/97, IRBRD, vol 12, 461
D69/98, IRBRD, vol 13, 412
Chun Yuet Bun Trading as Chong Hing Electrical Co v CIR 2 HKTC 325

68. It is the Taxpayer's case that there were two contracts of employment, one within Hong Kong and the other outside Hong Kong; the two contracts were negotiated and entered into by him in Country j, the Company K post was a new function which was not carried out when he was in Country j; there was a real functional distinction in the two contracts, a tactical role in Company B-AP and a strategic role in Company K; the works for Company B-AP were carried out in Hong Kong and those for Company K outside Hong Kong; and there were different reporting lines, to Hong Kong in Company B-AP and to Country a in Company K.

69. It is the Respondent's case that at the material times the Taxpayer was employed by Company B-AP only and that the alleged employment with Company K and the allocation of a part of the Taxpayer's remuneration to that alleged employment was a transaction entered into for the purpose of reducing the salaries tax liability of the Taxpayer and thus should be disregarded. The Respondent invoked section 61 of the IRO.

70. Hence, the questions for the Board to decide are whether in reality there was only one employment and the employment with Company K was an artificial transaction aiming to reduce the tax liability of the Taxpayer and should be disregarded under section 61 of the IRO.

71. Section 18(1)(a) of the IRO is the basic charging section for salaries tax which provides that salaries tax shall be charged on every person in respect of his income arising in or derived from Hong Kong from any office or employment. The expression 'income arising in or derived from Hong Kong' in section 8(1)(a) is referable to the locality of the source of income and not the place where the duties of the employee are performed. The place where the services are rendered is not relevant to the enquiry under section 8(1) as to whether income arises in or is derived from Hong Kong from any employment and should be ignored. These legal principles outlined in CIR v Geopfert [1987] 2 HKTC 210 are well established.

72. Thus if during the relevant years of assessment, the Taxpayer had only one employment and the location of his employment was Hong Kong, he would be liable to salaries tax on the whole of income from this employment under section 8(1)(a) although he was required to perform some of his duties outside Hong Kong in connection with his employment. Also, there is no provision for apportionment in such case.

73. The Taxpayer was first employed as marketing manager Asia/Pacific by Company B-HK in Hong Kong in 1987 and was transferred to a related company, Company B-AP, in 1988. In August 1988, he was relocated to Country j, taking up the position of Company B representative Country j/Country k. On 12 March 1990, he was transferred back to Hong Kong to take up the

post of PMM in Company B-AP and Company K respectively. In respect of these employments, these were two separate letters of appointment. The Taxpayer was paid in Hong Kong for his Company B-AP employment and in Country i for his Company K employment.

74. In considering whether there was in reality one employment or two, we bear in mind the following statements of Macdougall J in CIR v Goepfert at page 237, *'This does not mean the Commissioner may not look behind the appearances to discover the reality. The Commissioner is not bound to accept as conclusive, any claim by an employee in this connection. He is entitled to scrutinize all evidence, documentary or otherwise, that is relevant to this matter.'*

75. We are of the view that the following factors lend weight to the view that there was in reality only one employment.

76. The Taxpayer' s transfer to Hong Kong in 1990 was a continuation of his employment with Company B-AP from Country j. In both letters of appointment of 19 January 1990, promotion to the position of PMM was referred to. Promotion could only take place where there was a previous employment. The Taxpayer had only one previous employment, and that was with Company B-AP.

77. The memorandum dated 16 March 1990 submitted by Company B-AP to the Immigration Department for visa purpose was issued by the PMM, Mr I, to the Taxpayer. The subject of the memorandum was the Taxpayer' s appointment terms. The memorandum confirmed the Taxpayer' s appointment to the Asia Pacific regional office. No reference was made to the two letters of appointment nor to the appointment under Company K. The basic salary, housing allowance and bonus mentioned therein were respectively equal to the total amounts of those under the two letters of appointment.

78. The letter of 19 January 1990 from Company B-AP to the Taxpayer stated that the continued employment beyond the term would be subject to a review of the relative responsibilities and demands of the Taxpayer' s position in Company K and if Company K absorbed more (or less) of the Taxpayer' s time, higher (or lower) of his total costs would be borne by Company K.

79. Although Company K was said to have been wound up in about April 1998, no official notification of termination was given, nor was a termination letter issued, to the Taxpayer in respect of his employment with Company K. He only received one termination letter of 1 June 1998 which referred to a payment in lieu of 60 days notice and other compensation as discussed and a release agreement required to be signed. The Taxpayer signed only one release agreement which the Taxpayer said to cover ' everything' , meaning both Company B-AP and Company K employment. The payment under this termination letter covered also a payment in lieu of notice and the Taxpayer' s salary for April and May 1988 in respect of Company K.

80. The Taxpayer used only name cards bearing the name of 'Company F' for both Company B-AP and Company K.

81. In his oral testimony, the Taxpayer acknowledged that one employment agreement could not happen without the other or vice versa.

82. The two contracts of employment coexisted. The letters of appointment in respect of the Taxpayer's employment with Company B-AP and Company K were both dated the same date and signed by one and the same person, Mr H and the length of both employment were the same. Promotions to the position of PMM were referred to in both letters even though Company K's employment was a new one. Review of salaries and terms of the two employments were carried out at the same time and their effective dates were the same. The review letters were also signed by the same person, Mr J, on behalf of Company B-AP and Company K respectively.

83. Mr I on behalf of Company K informed the assessor through Ms L that the Taxpayer was employed by Company K to oversee all the sales and marketing activities of Company B products in Asia/Pacific region except Hong Kong. These activities in Company K corresponded with those in Company B-AP save the activities of Company B-AP were to be carried out within Hong Kong. Ms M of the Representatives also informed the assessor in similar terms. The duties within Company B-AP and Company K were similar, save for the locality of performance of those duties.

84. Having ascertained that there was in fact only one contract of employment, we also find that the employment was sourced in Hong Kong. In reaching this conclusion, we derive assistance from the following passage of Macdougall J in CIR v Geopfert at page 237:

> '*Specifically, it is necessary to look for the place where the income really comes to the employee, that is to say, where the source of income, the employment, is located. As Sir Wilfred Greene said, regard must first be had to the contract of employment...*
>
> *There can be no doubt therefore that in deciding the crucial issue, the Commissioner may need to look further than the external or superficial features of the employment. Appearances may be deceptive. He may need to examine other factors that point to the real locus of the source of income, the employment.*
>
> *It occurs to me that sometimes when reference is made to the so called "totality of facts" test it may be that what is meant is this very process. If that is what it means, then it is not an enquiry of a nature different from that to which the English cases refer, but is descriptive of the process adopted to ascertain the true answer to the question that arises under section 8(1).'*

85. The following factors persuade us to the conclusion that the employment was sourced from Hong Kong.

86. Company B-AP applied for visa on behalf of the Taxpayer.

87. The Taxpayer was based in Hong Kong. Company B-AP gave him the housing allowance. Company B-AP was a company incorporated in Hong Kong.

88. The Taxpayer' s payment in lieu of notice by Company K and the two months salary of April and May 1998 by Company K were booked as staff cost of Company B-AP.

89. The Taxpayer continued with the negotiations with Company S in Country e notwithstanding Company K had wound up.

90. Our aforesaid findings that there was in reality one contract of employment and it was sourced in Hong Kong could have disposed of the appeal. Nonetheless, we also find that the Taxpayer' s employment with Company K was an artificial transaction within the meaning of section 61 of the IRO.

91. Section 61 provides that where an assessor is of the opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the person concerned shall be assessable accordingly.

92. In determining whether section 61 applies to the present case, we bear in mind the submission by the Taxpayer' s Counsel that section 61 cannot have effect where the transaction sought to be impugned is one which was entered into to take advantage of a benefit or advantage conferred by a specific provision of the IRO.

93. Company K was a company incorporated in Islands d. It did not maintain an office in Hong Kong. We have no evidence that it maintained any office at all. It had no supporting staff, but only directors. According to the Representatives, the human resources function in Hong Kong distributed salary advices for Company K. As admitted by the Taxpayer in his ground of appeal, he himself knew very little about Company K.

94. Notwithstanding the winding up of Company K in April 1998, the Taxpayer continued to receive salary for April and May 1998 and the salary and payment in lieu of notice of Company K. This payment was made to the Taxpayer together with those of Company B-AP and was booked as staff cost in the accounts of Company B-AP.

95. The Taxpayer was unable to give any explanation as to the basis upon which he was remunerated by Company B-AP and Company K.

96. In discharging his duties in the strategic role, the Taxpayer did not need supporting staff. He relied mostly on his laptop computer for communication and record keeping. He only needed to work with the negotiating team from Country a. He reported to Mr H and Mr R, both stationed in Country a. There was no evidence that Mr H and Mr R were directors of Company K. He continued performing his strategic role notwithstanding Company K's winding up in April 1998. Company K relied on Company B-AP for salary distribution. It is apparent from these factors that even if there were functional distinction and different reporting lines in the two roles, strategic versus tactical, Company K did not play any part in the Taxpayer's performance of his strategic role. Hence, we are of the view that the interposing contract of employment with Company K was an artificial transaction for the purpose of reducing the tax liability of the Taxpayer and should be disregarded.

Section 61A

97. The Respondent had submitted that section 61A was an alternative argument to section 61. In view of our aforesaid findings, it is not necessary for us to further consider section 61A.

Time basis apportionment

98. Since we have found that the Taxpayer had only one employment and it was sourced in Hong Kong, all his income therefrom would be assessable to salaries tax under section 8(1)(a) and the question of time apportionment on 'days in, days out' basis would not apply.

Section 70A claim – year of assessment 1993/94

99. In view of our aforesaid findings, the claim that the tax charged for that year of assessment 1993/94 was excessive by reason of an error or omission in the return does not arise.

Late objection – year of assessment 1995/96

100. We agree to the submission made by the Respondent that the Board of Review is not the proper forum to consider whether the Commissioner is correct in refusing to accept the late objection lodged by the Taxpayer. The proper course of action would be an application for a judicial review.

Share options gain

101. Section 9 provides that income from any office or employment includes any gain realized by the exercise of a right to acquire shares in a corporation obtained by a person as an employee of that or any other corporation.

102. According to section 9(1)(d) of the IRO, a person would be assessed on the gain realized by him by the exercise of a right to acquire shares. It is the exercise of the option obtained rather than the mere grant of the option which gives rise to tax liability. In the present case, the option in question was exercised by the Taxpayer in the year of assessment 1993/94. Thus the resultant gain should be regarded as accrued to the Taxpayer in that year of assessment. In view of our aforesaid findings that the Taxpayer' s employment was sourced in Hong Kong, the gain from the exercise of the share option is therefore liable to tax.

103. For the aforesaid reasons, we hereby confirm the assessments referred to in the Determination and the Taxpayer' s appeal is hereby dismissed.