Case No. D67/87

Appeals – additional assessment – whether taxpayer could claim a deduction which had been disallowed on original assessment – s 64(1)(c) of the Inland Revenue Ordinance.

Profits tax – whether taxpayer an employee or independent contractor – s 14 of the Inland Revenue Ordinance.

Salaries tax – deductions – whether permitted – s 12(1) of the Inland Revenue Ordinance.

Salaries tax – whether taxpayer an employee or independent contractor – s 8(1) of the Inland Revenue Ordinance.

Panel: Robert W N Wei QC (chairman), Kenneth Ku and Anthony F Neoh.

Dates of hearing: 10 and 11 November 1987.
Date of decision: 15 March 1988.

The taxpayer was a band musician. He worked over two years for the same few restaurants. Instruments were usually supplied by the restaurants for his use. Other members of the band were paid by the restaurants. The taxpayer himself received a fixed hourly sum. He needed permission from the proprietors to absent himself, but could hire substitutes at his own expense. He was free to work in a number of restaurants. He practised at home. There was no fixed period for any engagement, nor was there any notice period for termination of an engagement. He received no sick lave, casual leave or severance pay. He did not register a business pursuant to the Business Registration Ordinance.

The taxpayer claimed deductions for the costs of (a) hiring substitute musicians from time to time, (b) hiring his father as his manager, (c) clothing and (d) records and tapes which he purchased for keeping up to date.

The taxpayer claimed that he was carrying on business. The Commissioner assessed him to salaries tax on the basis that he was an employee. [Editor's note: deductions are more readily allowed in the case of a taxpayer carrying on a business than in the case of an employee: hence the employee's need to show that he was an independent contractor.]

On a preliminary point, the taxpayer had been initially assessed after claiming a deduction for the cost of hiring substitute musicians. The claim was disallowed, the taxpayer did not object, and the assessment became final and conclusive under s 70. Upon receiving an additional assessment under s 60 with respect to undeclared income, the

taxpayer objected and claimed again that he was entitled to this deduction. In issue was whether such a claim could be made again.

Held:

The taxpayer was an employee. None of the deductions was allowable.

(a) Employee v independent contractor. The taxpayer could not be said to be performing services as a person in business on his own account (the 'economic reality' test). Lack of control by an employer over an employee's performance of duties is a factor pointing to, but not conclusive of, an independent contractor. Here, factors pointing to employment were that the taxpayer did not usually use his own equipment when providing services; his co-workers were not hired by him but by the restaurants concerned; he bore no financial risk, and had no opportunity to profit from sound management, as he was paid a fixed hourly rate; and he had little responsibility for investment and management.

The taxpayer's intention to be an independent contractor is a relevant factor, but his lack of registration under the Business Registration Ordinance indicated that he had no such intention.

(b) Deductions. The cost of the substitute musicians was not 'necessarily' incurred. The cost of the manager was not incurred 'in the production of assessable income'. The clothing was not sufficiently special to justify a deduction.

(c) Right to claim deduction again. The original assessment being final and conclusive, it was not open to the taxpayer to claim the same deduction with respect to the additional assessment. Also, no fresh liability was imposed, or existing liability increased, by the additional assessment which was a 'reassessment' for the purposes of s 64(1)(c).

Appeal dismissed.

Cases referred to:

Elson-Vernon Knitters Ltd v Sino-Indo-American Spinners Ltd [1972] HKLR 468
CIR v Burns (1980) 1 HKTC 1181
G v CIR (1961) 80 NZLR 994
Global Plant Ltd v Secretary of State for Health and Social Security [1971] 3 WLR 269
Lunney v CT (1958) 100 CLR 478
Market Investigations Ltd v Minister of Social Security [1969] 2 QB 173

Wan Tsang Yuk Ling for the Commissioner of Inland Revenue.
Lam Wai Hay for the taxpayer.

Decision:

1. This is an appeal by the Taxpayer against an additional salaries tax assessment for the year of assessment 1982/83 and salaries tax assessments for the years of assessment 1983/84 and 1984/85.

2. The 1982/83 salaries tax return lodged by the Taxpayer included a claim for deduction of $27,000 as wages paid to substitute workers. The assessor did not allow the deduction. In the notice of assessment dated 17 October 1983 the assessor stated as his reason for not allowing the claim that the outgoing claimed for was of a private nature and not necessarily incurred. The Taxpayer did not object to this assessment. By reason of section 70 of the Inland Revenue Ordinance, the assessment has become final and conclusive, and, in our view, cannot be re-opened as to the amount of the tax assessed or the manner in which such tax was calculated.

3. The assessor, on 24 September 1985, raised on the Taxpayer an additional salaries tax assessment for the year 1982/83 as follows:

Income per employer's returns	$94,985
Less: Income originally assessed	$76,000
Additional net chargeable Income	$18,985
Tax payable thereon	$ 4,746

Grounds of objection

4. The Taxpayer's former tax representatives by letter dated 24 October 1985 objected to the additional assessment on the ground that an outgoing of $19,600, being salary paid by the Taxpayer to another musician during the year ended 31 March 1983 who took his place when he was ill or otherwise took leave, should qualify for deduction. However, this sum of $19,600 was part of the $27,000 claim for deduction mentioned in paragraph 2 above which was disallowed by the assessor in the original assessment which has become final and conclusive because the Taxpayer did not object to it. In our view it is not open to the Taxpayer to raise the matter again and the objection to the additional assessment therefore fails.

Furthermore, we think that the objection is also caught by proviso (c) to section 64(1) of the Ordinance which provides in effect that, where the assessment is a reassessment, the person reassessed has no right of objection except to the extent to which a fresh liability is imposed or an existing liability is varied by reason of the reassessment. Proviso (c) was enacted in 1971 as a replacement of the original proviso (c). The Explanatory Memorandum to the Inland Revenue (Amendment) Bill 1971 states in paragraph 19 thereof that proviso (c) is part of the enactments to overhaul the provisions as to provisional assessments and that the amendments are technical in character and do not effect any change of a substantive nature. The original proviso (c) applied to additional assessments and amended assessments, whilst the current proviso (c) applies to reassessments. Semantically the word 'reassessment' may or may not include an additional assessment, but one is entitled to look at the Explanatory Memorandum for guidance (Elson-Vernon Knitters v Sino-Indo-Ameriean Spinners [1972] HKLR 468). Bearing in mind that it was not the intention of the legislature to make any change of a substantive nature, we are of the view that the references to reassessments in proviso (c) include references to additional assessments. This is therefore an additional and alternative ground on which the Taxpayer's objection to the additional assessment for 1982/83 fails.

Was Taxpayer an employee?

5. The central question for this appeal is whether the Taxpayer worked during the three years in question as an employee or as an independent contractor.

6. The Taxpayer gave evidence for himself. No other witnesses were called.

7. The Taxpayer was a musician performing in restaurants and coffee bars. He played the piano, the organ and electronic sound effect instruments. Occasionally he also sang pop songs. He worked on the average six to seven hours in the evening at two or more places, although in 1982/83 and 1983/84 he seemed to have worked less hours than in 1984/85. His main instruments were the piano and the organ which were provided for him at the places of work. He would use his own sound effect instruments, such as a Yamaha synthesizer, if the place of work did not provide the same. No special clothing was required for his performances. He was expected to play pop music and sometimes to sing pop songs, but otherwise there was no control as to music content. Usually he was paid $60 per hour consisting of about 45 minutes' work and 15 minutes' rest. There was no fixed period of engagement. Either side could terminate the relationship at any time and no period of notice was agreed or required. As it turned out, his relationships with those he worked for were on the whole continuous, particularly in 1983/84 and 1984/85. He enjoyed none of the usual benefits of an employee, such as casual leave, sick leave, severance pay, etc. To be absent from work, he was required to obtain his employer's permission and to find a substitute whom he had to pay out of his own pocket. He practised at home, and for that purpose he had his own piano and organ and also bought new issues of tape and disk recordings for study. He also claimed that in 1983/84 and 1984/85 he had employed his father as his manager.

8. There is no single conclusive test to identify an employee as distinct from an independent contractor. Various particulars of the evidence were relied upon by one side or the other in support of their contentions. On balance, we accept the submission made on behalf of the Revenue that the Taxpayer was an employee.

9. An employer normally has the power to direct and control the work of an employee. The Taxpayer's job was to play pop music and sing pop songs, but otherwise there was no control as to music content or how he was to perform his duties. Mr Lam, the Taxpayer's tax representative, pointed to this as a factor in his favour. However, just because there is no control, or because the control is insignificant or negligible, it does not in our view necessarily follow that the person who has engaged himself to do the work is an independent contractor. 'The fundamental test to be applied is this: "Is the person who has engaged himself to perform these services performing them as a person in business on his own account?" If the answer to that question is "yes", then the contract is a contract for services. If the answer is "no", then the contract is a contract of service. No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of the considerations which are relevant in determining that question, nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases. The most that can be said is that control will no doubt always have to be considered, although it can no longer be regarded as the sole determining factor; and that factors which may be of importance are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk he takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task' (Market Investigations Ltd v Minister of Social Security [1969] 2 QB 173, at 184.) This has come to be known as the economic reality test.

10. Was the Taxpayer a person in business on his own account in relation to the work he did during the accounting period? To answer this question, it is necessary to consider a number of factors.

(a) Did he provide his own equipment? In our view the answer is 'no'. He sometimes used his own synthesizer. Subject to that, the restaurants and coffee bars provided the piano and the organ. He had his own piano and organ at home for practice purposes, but the fact remains that he did not use them to perform the services.

(b) Did he hire his own helpers? The answer is 'no'. Sometimes he worked as a band leader and chose his own band players, but they were employed and paid by the restaurant or coffee bar concerned.

(c) What financial risk did he take? He was paid at a fixed rate according to the number of hours he worked. There was no risk except that of termination of his engagements.

(d) What degree of responsibility for investment and management did he have? None except that he invested in equipment, most of which he kept at home, and in his skills.

(e) Did he have an opportunity of profiting from sound management in the performance of his task? No. He was paid at a fixed hourly rate and he played an agreed number of hours at each place of work in the evening.

(f) The Taxpayer claims that he employed his father as his manager during 1983/84 and 1984/85. His evidence is that his father was well connected with restaurants and coffee lounges, and that his father's previous occupation was an engineer of some kind concerned with knitting and weaving machinery. No explanation was offered as to how his father had come to be well connected with restaurants and coffee lounges after a career as an engineer. Nor was his father called as a witness. There is no evidence as to the nature or details of his duties as a manager. In the circumstances we are not satisfied that his father worked as his manager during those two years.

(g) Mr Lam submitted that, as there was no agreed period of notice for the termination of the engagement, it did not fall within the ambit of section 6 of the Employment Ordinance and therefore was not a contract of service. With respect, we disagree. Neither section 6 nor any other provision of that Ordinance lays down any criteria for identifying a contract of service. Whether a contract is a contract of service or a contract for services is determined independently of the Employment Ordinance, but only a contract of service attracts the application of that Ordinance which confers and imposes certain rights and obligations on the employer and the employee. In our view, the fact that a contract for the rendering of services does not provide for any period of notice of termination does not for that reason preclude it from being a contract of service.

(h) Mr Lam relied on the case of G v CIR (1961) 80 NZLR 994 for the proposition that the essential test as to whether a taxpayer is carrying on a business is his intention as evidenced by his conduct, and that the various tests discussed in the decided cases are merely tests to ascertain the existence of that intention. The parties' intention is a factor for consideration but is not conclusive on the question whether the taxpayer is carrying on business on his own account: Global Plant Ltd v Secretary of State for Health and Social Security [1971] 3 WLR 269, 279.

Furthermore, in the present case we are not satisfied that the Taxpayer's intention was that the relationship should be that of an independent contractor. On 1 June 1983 the Taxpayer as partner applied for the registration of a partnership business. The business is stated to have

commenced on the same date and the Taxpayer filled out the application form. This shows, as Mrs Wan for the Revenue contends, that he was aware of the requirement that a business has to be registered, and yet during the three tax years ended 31 March 1985 he did not apply for registration of himself as an individual carrying on business. He applied for registration on 18 April 1986 as a free lance artist and the date of commencement of that business was stated to be 1 April 1983. As the application was made well after the accounting period, we do not feel able to give it any weight.

(i) Mr Lam also relied on the fact that the Taxpayer was free to work for more than one restaurant or coffee bar as a pointer to the Taxpayer being an independent contractor.

11. Having considered all the relevant factors we have come to the conclusion that the Taxpayer was an employee in relation to all his engagements in question and that his contract with each of the restaurants or coffee bars was one of service and not one for services.

Claim for deductions

12. Now we deal with the Taxpayer's claim for deductions for outgoings and expenses on the footing that he was an employee. Under section 12(1) of the Inland Revenue Ordinance, only those outgoings and expenses which are wholly, exclusively and necessarily incurred in the production of the assessable income are deductible.

(a) Salaries to substitute musicians. We accept that the Taxpayer had to engage and pay substitute musicians if he was absent from work, but he has failed to substantiate the payments. He produced no document such as receipts, nor did he call any of the musicians (one of whom was said to be his younger brother) to give evidence. Furthermore, we are of the view that these alleged payments are not deductible anyway because, as was submitted for the Revenue, it has not been established that they were necessarily incurred in the sense that, on each occasion when he engaged a substitute to take his place, he did not have the choice of performing the duties in person.

(b) Salaries to manager. We have already stated that it has not been proved to our satisfaction that the Taxpayer's father worked as his manager. In any event, there is no evidence to show that the stringent tests laid down in section 12(1) have been satisfied. In particular we do not think that payments of this nature can be said to have been incurred in or in the course of gaining or producing income: CIR v Burns (1980) 1 HKTC 1181, 1190; Lunney v CT (1957) 100 CLR 478, 498.

(c) Clothing expenses. This head fails because the Taxpayer was not required to and did not wear special clothing in performing his duties.

(d) Records and tapes. Again we do not think that the tests of section 12(1) have been satisfied in respect of this head.

13. It follows therefore that this appeal is dismissed and that the additional assessment for 1982/83 and the assessments for 1983/84 and 1984/85 are hereby confirmed.