Case No. D68/06

Salaries tax – where source of income was located – totality of facts test – whether income should be fully assessed or partly assessed on a time apportionment basis – sections 8(1)(a), 8(1A)(a) of the Inland Revenue Ordinance ('IRO')

Panel: Colin Cohen (chairman), Vincent Kwan Po Chuen and David Li Ka Fai.

Date of hearing: 2 November 2006.
Date of decision: 14 December 2006.

On 23 June 1994, the taxpayer entered into a contract of employment with Company A – Country B. The contract was signed by both parties in Country B and provided for various employment terms. However, the taxpayer confirmed that he never received any salary pursuant to that contract. On the same date, the taxpayer entered into another contract of employment with Company A – Regional Office: China & South East Asia, which is the trading name of a company called Company A – Group Hong Kong Limited ('Company A – Hong Kong'). The contract provided that he would be seconded to the regional office on various terms.

The taxpayer applied for an employment visa and for subsequent extensions. The correspondence showed that the applications for his visa extension was made on behalf of Company A – Hong Kong.

By further agreements made in 1996, 1998 and 2001, the taxpayer agreed to extend his assignment in Hong Kong. The last two agreements were entered into by Company A – Hong Kong. In the salaries tax assessment for some of the years of assessment in issue, the taxpayer did not set out with whom he was employed whereas for other years of assessment in issue, Company A – Hong Kong was inserted as the employer. The taxpayer had a Hong Kong bank account and all his salary was paid into that bank account. He was provided with accommodation in Hong Kong.

The taxpayer claimed that he was at all times employed by Company A – Country B and was seconded to Hong Kong. He submitted that his income had all along been derived from that employment.

Held:

1. The correct approach in identifying the source of income is to consider the totality and all factors and circumstances arising in each particular case. The key question one has to ask is: where is the locality of the contract for payment of salary? In this respect, the locality of the actual payments for the employment is highly relevant (CIR v Goepfert; D79/97 applied).

2. Having considered all relevant factors, it is quite clear that the taxpayer's income under appeal arose in or was derived from Hong Kong. There was no evidence to show that the taxpayer declared his employment income to the relevant tax authorities in Country B or paid any tax in respect of his employment income in any territory outside Hong Kong. The totality of the evidence clearly supports a contractual relationship between the taxpayer and Company A – Hong Kong and that his income arose in or was derived from Hong Kong from his office of employment with Company A – Hong Kong.

3. There is as such no actual definition of secondment. Secondment can refer to a temporary employment at the end of which the employee returns to his general appointment. However, one must look at the circumstances of each particular case. Here, it is quite clear that in order to regulate the taxpayer's presence in Hong Kong, he had entered into a series of separate agreements with Company A – Hong Kong.

4. All remuneration of the taxpayer's salary and bonuses was paid by Company A – Hong Kong in Hong Kong dollars. It is also clear that housing allowances were paid in Hong Kong and that all of these were consistent with the relevant declarations set out in the Company A – Hong Kong's returns filed for the taxpayer. It is also clear that the taxpayer's duties and responsibilities were for him to be based here in Hong Kong although he had to travel extensively around the region. There were clear representations to the IRD as to Company A – Hong Kong being the employer and there were the representations made to the Director of Immigration advising that Company A – Hong Kong was his employer (D79/97 applied).

Appeal dismissed.

Cases referred to:

CIR v Goepfert 2 HKTC 210
D87/00, IRBRD, vol 15, 750
D79/97, IRBRD, vol 12, 461
D55/91, IRBRD, vol 6, 424
D37/03, IRBRD, vol 18, 500

Fiona Chan Counsel instructed by Messrs Cheung, Fung & Hui, Solicitors, for the taxpayer.
Lai Wing Man and Chan Wai Yee for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal by the Taxpayer in respect of a determination by the Deputy Commissioner of Inland Revenue dated 28 April 2006 in respect of a series of additional salaries tax assessments for the years 1995/96 to 2000/01 and salaries tax assessment for the year 2001/02 inclusive. The Taxpayer lodged a notice of appeal dated 26 May 2006.

2. The issue for us to determine is whether the Taxpayer's employment income should be fully assessed under section 8(1)(a) of the Inland Revenue Ordinance ('IRO') or partly assessed on a time apportionment basis under section 8(1A)(a) of the IRO.

3. The principal submission on behalf of the Taxpayer was that his income has all along been derived from his employment with a company known as Company A – Country B. In short, the submission put forward to us was that the Taxpayer had been employed by Company A – Country B and there was in turn a secondment to Hong Kong to work overseas as a Regional Client Support Manager for the Regional Office.

4. Section 8 of the IRO provides as follows:

> *'(1) Salaries tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from the following sources –*
>
> *(a) any office or employment of profit; …*
>
> *(1A) For the purposes of this Part, income arising in or derived from Hong Kong from any employment –*
>
> *(a) includes, without in any way limiting the meaning of the expression and subject to paragraph (b), all income derived from services rendered in Hong Kong including leave pay attributes to such services; …'*

5. The leading case of CIR v Goepfert 2 HKTC 210 at 238 clearly sets out the various principles applicable in respect of this matter. Macdougall J stated as follows:

> *'If during a year of assessment a person's income falls within the basic charge to salaries tax under section 8(1), his entire salary is subject to salaries tax wherever his services may have been rendered, subject only to the so called "60 days rule" that operates when the taxpayer can claim relief by way of exemption under section 8(1A)(b) as read with section 8(1B). Thus, once income is caught by section 8(1) there is no provision for apportionment. …..*
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> *On the other hand, if a person, whose income does not fall within the basic charge to salaries tax under section 8(1), derives income from employment in respect of which he rendered services in Hong Kong, only that income derived from the services he actually rendered in Hong Kong is chargeable to salaries tax. Again, this is subject to the "60 days rule".'*

6. Macdougall J also sets out the correct approach in identifying the source of income. He stated at page 237 as follows:

> *'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 Wilfrid Greene said, regard must first be had to the contract of employment.*
>
> *This does not mean that the Commissioner may not look behind the appearances to discover the reality. The Commissioner is not bound to accept as conclusive, any claim made by an employee in this connexion. He is entitled to scrutinise all evidence, documentary or otherwise, that is relevant to this matter. …*
>
> *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.'*

7. We have also considered the Board of Review Decisions D87/00, IRBRD, vol 15, 750, D79/97, IRBRD, vol 12, 461, D55/91, IRBRD, vol 6, 424 and D37/03, IRBRD, vol 18, 500.

8. From these authorities and decisions, it is quite clear that the correct approach in identifying the source of income was to consider the totality and all factors and circumstances arising in each particular case. In particular, this was endorsed by the Goepfert decision. In D79/97, the Board stated at page 465 that:

> *'It follows that the key question we have to ask ourselves is: where is the locality of the contract for payment of salary? In this respect, the locality of the actual payments for the employment is highly relevant.'*

9. We also refer to section 68(4) of the IRO which provides as follows:

> *'The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'*

Hence, it is up to the Taxpayer to discharge the burden of proof in respect of this matter.

Evidence

10. The Taxpayer gave evidence before us and provided us with details of his employment.

11. He was employed by Company A – Country B and drew our attention to an agreement dated 23 June 1994. This agreement was signed by both parties in Country B. The various terms and conditions were set out in this agreement and in particular, we note the following:

(a) Clause 2 stated that 'Your basic salary will be $87750 [in Country B's currency] per annum, which will be paid in 13 equal monthly instalments, two at Chinese New Year.'.

(b) On cross examination, he accepted and confirmed that he never did receive any salary pursuant to this agreement.

(c) Clause 6 dealt with his employment provident fund and stated that 'In accordance with the laws of [Country B], you will be enrolled in [Company A – Country B's] corporate provident fund, which provides for a company contribution of 12% of your salary. Full details of EPF arrangements will be provided to you separately.'

(d) It is also noted that under clause 8, the agreement can be capable of termination by three months' notice in writing by either party.

12. However, there was a further contract of employment and this was between the Taxpayer and Company A – Regional Office: China & South East Asia. This was also dated 23 June 1994. This particular entity is the trading name of the company that was formally known as Company C and now known as Company A – Group Hong Kong Limited ('Company A – Hong Kong'). However, the letter was sent by facsimile transmission from Hong Kong to the Taxpayer by Mr D and in turn, this was sent back to Hong Kong signed and accepted by the Taxpayer on the 1 July 1994. This agreement was a confirmation of an offer of employment whereby he was to be seconded to the regional office on various terms and conditions. His salary was in the sum of HK$500,000 payable by twelve equal monthly instalments. It was for a minimum of a two-year period and may be extended by mutual agreement. The agreement also provided that he would continue to be subject to the Country B's employment provident fund regulations and would make the relevant contributions at a basic annual notional salary of $87,750 [in Country B's currency] per annum upon taking up his secondment and Clause 8 also provided:

> 'You will be paid wholly in Hong Kong and will be subject to local taxation and other statutory deductions in force. You will be responsible for any dealings with the tax authorities in respect of your income. You will be personally responsible for your liabilities.'

There was also a notice period of three months. It is of interest to note that this was again a short form agreement.

13. The Taxpayer also drew our attention to his immigration status. He initially applied for and was granted an employment status visa that enabled him to remain in Hong Kong on an employment visa from 25 July 1994. This was for an initial period of one year. Thereafter, there was a series of applications to extend his stay in Hong Kong. However, what is clear is that the relevant correspondence clearly shows that the applications for extending his work visa were made on behalf of Company A – Hong Kong. In particular, there was a letter dated 7 April 2003 from the Chief Financial Officer of Company A – Hong Kong which stated that the Taxpayer had been in employment with Company A – Hong Kong since 1 July 1994.

14. On 17 April 1996, the Taxpayer was promoted to Regional IT Manager, his salary was increased from HK$550,000 to HK$710,000 per annum with his next salary review on 1 July 1997. By a further agreement dated 8 August 1997, the Taxpayer was advised of the intention to extend his assignment in Hong Kong for a further two-year period and any further extensions would be confirmed on or around 30 June 1999. Again, his salary was increased from HK$710,000 to HK$766,800 per annum.

15. On 25 March 1998, there was a letter from Company A – Asia, Company A – Asia was the business name for Company A – Hong Kong. This was a detailed letter which sets out the Taxpayer's terms and conditions of employment. He would be employed on assignment from Company A – Country B and it was for a further term of three years from 1 April 1998. However,

this agreement could be terminated any time by either party giving not less than six months' notice in writing. Detailed housing benefits were set out in this letter along with further provisions in respect of pension, medical insurance, relocation and airfares. The provisions with regard to termination were set out at some length and his employment could be terminated for cause. There was also post-termination and restrictive covenant obligations imposed upon the Taxpayer. The Taxpayer confirmed his agreement on 4 May 1998.

16. On 5 March 2001, there was a further letter from Company A – Asia to further extend the terms of employment for a further three years from 1 April 2001. Again, the Taxpayer confirmed his acceptance to these terms and conditions.

17. However, the Taxpayer was adamant that all along he was of the view that he was always employed by Company A – Country B and was just seconded to Hong Kong. When he was asked about the representations made to the Director of Immigration, he could not provide us with an explanation.

18. His attention was also drawn to various returns made to the Inland Revenue Department ('IRD') and in particular for the years of assessment 1995/96, 1996/97, 1997/98 and 1998/99, he did not complete with whom he was employed and left these particulars blank. When asked why, he could not give any satisfactory or plausible explanation to us. It was put to him that if he was of the view that he was employed by Company A – Country B, why would he not insert that company's details in the relevant box. He could not provide any explanation.

19. For the years of assessment 1999/2000 and 2000/01, it is quite clear that Company A – Hong Kong was inserted as the employer. On cross-examination and on questions put to the Taxpayer by the Board, he took the view that this again was a mistake and did not reflect the true position. He also indicated to us that he did not receive any Country B salary nor did he pay any Country B tax. However, he did draw our attention to the fact that he continued to make payment for his Employment Provident Fund in Country B ('Country B's EPF'). He indicated to us that this was by way of deductions from his salary here in Hong Kong.

20. We note that there was a Certificate of Exemption under the Occupational Retirement Schemes Ordinance (Chapter 426) which enabled the Taxpayer to continue making payments in Country B and as such it had been accepted by the Mandatory Provident Fund Schemes Authority that since he had a valid scheme in Country B, he did not need to make contributions to the MPF Fund here in Hong Kong. We also accept that it was quite clear that there were deductions being made from his salary here in Hong Kong in respect of the Country B's EPF.

21. The Taxpayer also drew our attention to his various reporting lines. It seems clear that he had to report first to various persons in Country E and then subsequently to Country F. He also indicated that if any decision was going to be made to terminate him, then this would have to be done by those persons either in Country E or in Country F. However, it is in our view quite clear

that the terms of his employment provide that in the event of there being any termination, such notices would have to be given to him by Company A – Hong Kong.

22. The Taxpayer also confirmed that he was paid here in Hong Kong. He had a Hong Kong bank account and all of his salary was paid into that bank account. He also confirmed and accepted that he was provided with accommodation and premises for him to live here in Hong Kong and has always resided in Hong Kong since 1 July 1994.

23. We have no difficulties in finding that the Taxpayer was at all times based at Company A – Hong Kong' s office here but we accept that he was required to perform his duties on a regional basis which required him to travel throughout the region.

24. We also find that the Taxpayer' s salary and bonuses were always paid in Hong Kong and in Hong Kong dollars and paid into a bank account here in Hong Kong. We also find that the Taxpayer was also provided and giving a housing allowance to cover his various rental payments. We also find that Company A – Hong Kong has also continuously represented to the Director of Immigration that the Taxpayer was employed by them since July 1994. We also find that in the relevant returns to the IRD, it was clearly represented that the Taxpayer was employed by Company A – Hong Kong.

25. The Taxpayer also called Miss G. Miss G was a Human Resources Administrator for Company A – Hong Kong. She confirmed that her employer was Company A – Hong Kong, however, it was quite clear that Company A – Hong Kong always made use of its branch name – Company A – Asia. Her view however was that all along in her mind the Taxpayer had been seconded to the Hong Kong regional office. However, she accepted that the representations made to the Director of Immigration and to the IRD made it perfectly that the Taxpayer' s employment was with Company A – Hong Kong. She also confirmed that she was aware as to the fact that there were deductions from the Taxpayer' s Hong Kong salary to enable payments made to the Country B's EPF. No other evidence was called on behalf of the Taxpayer in respect of this matter.

Our analysis

26. Miss Fiona Chan on behalf of the Taxpayer submitted that the Taxpayer' s income had all along been derived from Company A – Country B and as such, this company will be the ultimate principal employer and this remained unchanged at all times irrespective of the location of his services. However, it is quite clear that we cannot agree with such a submission.

27. Having considered all relevant factors, it is quite clear that the Taxpayer' s income under appeal arose in or was derived from Hong Kong. In our view that Hong Kong was the place where his income was derived from. Looking at all of the facts before us and having regard to the totality of facts, it is unequivocal that this was the true position. There was no evidence to show that

the Taxpayer declared his employment income to the relevant tax authorities in Country B or paid any tax in respect of his employment income in any territory outside Hong Kong.

28. The totality of the evidence clearly supports a contractual relationship between the Taxpayer and Company A – Hong Kong and that his income arose in or was derived from Hong Kong from his office of employment with Company A – Hong Kong.

29. We also accept the submissions put forward by the IRD that there is as such no actual definition of secondment. Secondment can refer to a temporary employment at the end of which the employee returns to his general appointment. However, one must look at the circumstances of each particular case. Here, it is quite clear that in order to regulate the Taxpayer's presence in Hong Kong, he had entered into a series of separate agreements with Company A – Hong Kong.

30. We also find that there is no dispute that Company A – Hong Kong had its place of residence here in Hong Kong and its place of business in this jurisdiction. It is also clear that all remuneration of the Taxpayer's salary and bonuses was paid by Company A – Hong Kong in Hong Kong dollars. It is also clear that housing allowances were paid in Hong Kong and that all of these were consistent with the relevant declarations set out in the Company A – Hong Kong's returns filed for the Taxpayer. It is also clear that the Taxpayer's duties and responsibilities were for him to be based here in Hong Kong although as we have previously said he had to travel extensively around the region.

31. We also rely heavily upon the fact that there were clear representations to the IRD as to Company A – Hong Kong being the employer. We also rely on the representations made to the Director of Immigration advising that Company A – Hong Kong was his employer. Although the Taxpayer had tried to contend that all along his true and proper employer was Company A – Country B, from an objective and careful review of the facts before us, this was not made out.

32. Again, we rely on D79/97 where regard must be had to how his remuneration was paid. Here, it is quite clear that all remuneration was paid in Hong Kong and in Hong Kong dollars. The Taxpayer tried to suggest that this was only paid as a matter of convenience. Again, we reject this particular submission.

33. Hence, we have no hesitation in coming to the conclusion having regard to the totality of all facts and having regard to the above findings, there is no doubt that the Taxpayer's income should be fully assessed under section 8(1)(a) of the IRO. We have no hesitation in dismissing the appeal and we confirm the relevant determinations for the years of assessment.