Case No. D68/88

Salaries tax – source of employment income – taxpayer employed in Hong Kong and sent overseas – whether income earned while overseas arose in or derived from Hong Kong – s 8(1) of the Inland Revenue Ordinance.

Panel: H F G Hobson (chairman), Joseph S Brooker and David Wu Chung Shing.

Dates of hearing: 1 and 2 December 1988.
Date of decision: 13 February 1989.

The taxpayer, who was a Hong Kong resident, was employed in Hong Kong by a Hong Kong company which decided to set up a subsidiary to commence manufacturing operations in Portugal. The taxpayer was sent there for ten months to establish a subsidiary company and supervise its activities. He returned to Hong Kong for five months, and was then sent to the Philippines for four months to supervise the company's subsidiary's operations there.

The taxpayer claimed that, in each case while he was overseas, he was employed by the relevant subsidiary and that therefore his salary during those periods did not have a Hong Kong source. However, no clear evidence was available to support his claim. His salary had been paid all along by the Hong Kong company in Hong Kong and, in his salaries tax returns, he had stated that his employer at all times was the Hong Kong company.

The IRD assessed the taxpayer to salaries tax on the whole of his income earned while he was in Portugal and the Philippines. The taxpayer appealed.

Held:

The taxpayer's salary was subject to salaries tax.

(a) The taxpayer's evidence that he was employed by the Portuguese and Philippine subsidiaries was not convincing. What evidence there was pointed to the conclusion that at all times the taxpayer remained an employee of the Hong Kong company.

(b) The taxpayer's contract of employment was entered into in Hong Kong, he was normally resident in Hong Kong and his salary was paid in Hong Kong. In the circumstances, his salary was sourced in Hong Kong and was therefore subject to salaries tax.

Appeal dismissed.

Cases referred to:

Bennet v Marshall (1937) 22 TC 73
CIR v Goepfert (1987) 2 HKTC 210
Pickles v Foulsham (1925) 9 TC 261

Leung Yiu Hon for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The Taxpayer was assessed to salaries tax for the two years of assessments 1985/86 and 1986/87 during which he was working for about 10 months in Portugal and later nearly 4 months in the Philippines.

The issue before us was whether the Taxpayer's income received while he was engaged in the off-shore work was subject to Hong Kong salaries tax. It is clear from the authorities (in particular CIR v Goepfert (1987) 2 HKTC 210, referred to us by the Revenue's representative) that, so far as liability to salaries tax under section 8(1) of the Inland Revenue Ordinance is concerned, it is the source of the income rather than the source of the employment that is the determining factor. Where, therefore, upon enquiry it is clear that a taxpayer's salary arises in Hong Kong, then it matters not where he performs his employment services.

1. The following facts were not in dispute:

1.1 The Taxpayer was employed as a sales manager by X Limited of Hong Kong in 1984. There was no written contract of employment.

1.2 For approximately 10 months from 1985 to 1986, the Taxpayer was working in Portugal.

1.3 From June 1986 until he went to the Philippines, he worked in Hong Kong for an associate of X Limited.

1.4 He went to the Philippines in December 1986 returning about 4 months later in March 1987 whereafter, he continued to work for X Limited until he left at the end of August 1987.

2. The Taxpayer does not dispute that, in its employer's returns, X Limited showed the Taxpayer as its employee at all relevant times, including the periods when he was in Portugal and the Philippines. (X Limited reaffirmed this in response to an enquiry by the Revenue in connection with this case.) Nor does the Taxpayer dispute that, in his own salaries tax returns, he put X Limited down as his employer at all relevant times.

3. The Taxpayer argued that his engagements in Portugal and the Philippines, being different in character to his normal duties as sales manager, should be 'considered to be negotiated and entered into and enforceable outside Hong Kong ...'

4. The Taxpayer, who was unrepresented, testified to the effect that he had been asked by the management of X Limited to conduct a study in England, Ireland and Portugal as to the feasibility of establishing a factory in one of those countries. He was given two weeks to undertake the study. On a visit to him in Portugal, the directors concluded that Portugal was suitable and he was given the task of establishing a local corporation (X Limited (Portugal), to be owned by X Limited) which would establish the factory. This he did, and indeed he was evidently the factory's first manager. X Limited (Portugal) was not incorporated until many months after the Taxpayer had been in Portugal. X Limited (Portugal), he said, has a staff of 200, though we are unsure whether it had reached that number before the Taxpayer left. The Taxpayer produced certain hand-written notes (on a Lisbon Hotel's note-paper) which he asserted were made by a X Limited director on the directors' initial visit to him, as evidence of the fact that it was intended that he be employed by X Limited (Portugal). He further stated that X Limited (Portugal) provided him with dormitory accommodation and on his behalf paid his local salaries tax. He acknowledged that, whilst he was in Portugal, X Limited continued to pay 'salary' into his Hong Kong bank account and that, other than a food allowance which he received from X Limited (Portugal), he received no money from X Limited (Portugal).

5. The Taxpayer submitted that his employment with X Limited ceased when its directors decided to proceed with establishing a factory in Portugal whereupon he became an employee of X Limited (Portugal). These directors were also directors of X Limited (Portugal). He maintained that the salary paid to him in Hong Kong by X Limited was done on behalf of X Limited (Portugal) and the former reimbursed itself out of the cost of purchasing goods from X Limited (Portugal). His reasons for continuing to file Hong Kong salary tax returns showing X Limited as his employer were difficult to understand; so far as we could gather it was simply that he did not think the matter through, particularly as X Limited owned X Limited (Portugal).

6. As for his engagement in the Philippines, the Taxpayer testified that it followed, with a Philippine subsidiary of X Limited, a pattern similar in all material respects to that for Portugal. He could produce no written evidence at all to support his assertions.

Whilst we accept that it was quite within the realms of commercial possibility for the Taxpayer to have ceased employment with X Limited and to have been employed by the

overseas companies, all the formal extraneous evidence contradicts that possibility. The Taxpayer's explanation regarding his own tax returns was extremely weak, and the papers he produced in support of his employment by X Limited (Portugal) fell far short of credible evidence. We quite understand that, having now left X Limited, the Taxpayer would experience considerable difficulty in persuading any of X Limited's key personnel to testify. Nonetheless, we do not see how we could accept undocumented, uncorroborated assertions from the Taxpayer when, in so doing, we would in effect be holding that the employer's returns by X Limited (which would themselves serve to justify deductions against their own profits tax returns) were false.

For the foregoing reasons, we find as a matter of fact that the Taxpayer remained in the employ of X Limited which paid his salary in Hong Kong (Pickles v Foulsham (1925) 9 TC 261) and that, as that employment was entered into in Hong Kong – where the Taxpayer was normally resident – 'regard must first be had to the contract of employment' (per Sir Wilfred Greene in Bennet v Marshall (1937) 22 TC 73). Accordingly, the salary paid during his overseas engagements is subject to Hong Kong salaries tax. The appeal therefore fails and the assessments concerned are hereby confirmed.