Case No. D68/89

Salaries tax – whether an employee or carrying on business.

Panel: Howard F G Hobson (chairman), Alexander Au Siu Kee and Charles Hui Chun Ping.

Dates of hearing: 21 and 22 August 1989.
Date of decision: 31 October 1989.

The taxpayer was assessed to salaries tax on money received by him from a company which the assessor said was his employer. The taxpayer submitted that he had a contract for services and was not an employee.

Held:

There was no merit in the submission made by the Taxpayer who was an employee and subject to salaries tax.

Appeal dismissed.

Cases referred to:

Fall v Hitchen 49 TC 433
Market Investigations Ltd v Minister of Social Security [1969] 2 QB 173
Bank Voor Handel v Slatford [1952] 2 All ER 956
D19/78, IRBRD, vol 1, 323
D67/87, IRBRD, vol 3, 97

Wong Yui Keung for the Commissioner of Inland Revenue.
Alfred K Wong of Alfred K Wong & Co for the taxpayer.

Decision:

This appeal is against a salaries tax assessment raised upon the Taxpayer for the year 1985/86 with regard to commissions received by the Taxpayer.

1. FACTS, TESTIMONY & EVIDENCE

1.1 The basic facts are as follows:

1.1.1 With effect from 1 August 1982 the Taxpayer became an accounts executive trainee with X Limited, a majority owned subsidiary of Y Limited, on the terms and conditions outlined in a letter dated 12 August 1982. As no distinction material to this appeal was taken at the hearing between these two companies, we will refer to them simply as X Limited.

1.1.2 With effect from 1 November 1982 the Taxpayer was appointed as an assistant accounts executive with terms and conditions amended to the extent outlined in the X Limited's letter of 20 January 1983 including the cessation of certain staff benefits from 1 January 1983.

1.1.3 As from 25 March 1986 the Taxpayer was redesignated as an assistant vice president of X Limited.

1.1.4 X Limited furnished a 1985/86 employer's return regarding the Taxpayer which disclosed the following particulars:

1.1.4.1 Capacity in which employed: assistant vice president

1.1.4.2 Period of employment: 1 April 1985 to 31 March 1986

1.1.4.3 Commission: $335,406

1.1.5 In his salaries tax return submitted on 9 June 1986 for the year 1985/86, the Taxpayer stated that he derived no employment income and his income has been reported as profits of his business under the style of 'Company A'.

1.1.6 On 29 June 1987 he was assessed to salaries tax on the said $335,406. To this he objected on the ground that the assessable income was not salary but was the gross income of the Taxpayer's business to which reference is made above.

1.2 The Taxpayer's representative addressed us on the grounds of appeal, which in effect constituted his submissions on behalf of the Taxpayer. He maintained that the two contracts to which reference had been made at paragraphs 1.1.1 and 1.1.2 above were not employment contracts but were contracts for services. He went on to distinguish the Taxpayer's activities from that of X Limited's normal employees viz: the Taxpayer's working hours were flexible – indeed he mostly worked at X Limited from mid-afternoon till midnight – he had no one to substitute for him whereas normal employees could expect other employees to undertake their work when away from X Limited's office. With effect from 1 January 1983 his position in X Limited changed consequently, unlike other employees, he was no longer entitled to staff benefits, retirement scheme etc. Moreover the Taxpayer was thereafter remunerated strictly on a commission

basis and received no business or share of profits. If he chose not to work he received no remuneration.

The Taxpayer's representative contended that the Taxpayer had to look after his own clients only in placing orders in accordance with their instructions, accordingly the financial risks were his own, and he would have to meet any loss suffered by X Limited due to any failure on his part and the same was true of any losses suffered by his clients as a result of his errors in placing orders.

The grounds of appeal also stated that whilst the Taxpayer was provided with equipment, secretaries and other facilities by X Limited he was charged their cost at a present rate. The Taxpayer also had to bear all expenses himself.

Finally the representative submitted that the fact that the Taxpayer's income for the years of assessment 1982/83 to 1984/85 had been assessed to salaries tax was irrelevant for the year 1985/86.

1.3 Following this opening the Taxpayer testified as follows:

1.3.1 On behalf of his clients, he placed commodity futures and financial future orders and would charge his client a commission of US$80 per contract which would be paid to X Limited. From that amount X Limited would deduct US$10 as 'clearing costs' and the remaining US$70 would be shared between the Taxpayer and X Limited in respect to proportions of 40% and 60%.

1.3.2 In other types of future transactions the same principle applied although the commission charged to the clients might be less but the balance after deduction of X Limited's clearing charge would be shared in the same ratio. He argued that the amounts taken by X Limited were the Taxpayer's contribution to X Limited's overheads.

1.4 The Revenue's representative then produced a file of copy papers and correspondence, which were accepted in evidence. These included the Taxpayer's returns for 1981/82 to 1984/85 in which he showed himself as an employee of X Limited, his business registration application of 27 May 1986 in which he stated he commenced business as 'financial (future commodities)' on 1 January 1985 from his home. The letters referred to at paragraphs 1.1.1 and 1.1.2 above were also included, the first of which refers to the 'terms of your employment', 'a monthly salary' and states that the Taxpayer 'will be bound by all company regulations', including monitoring records, of securing credit limits laid down by X Limited. The second letter begins 'we have pleasure to confirm your employment … you will receive a monthly guarantee of $5,000 which will be set against your commission pay-out … Other terms of employment as stated in your last employment letter remain the same …'

1.4.1 In cross-examination the Taxpayer acknowledged that it was X Limited, not himself, that charged the clients. His attention was drawn to the copy of a letter dated 12 November 1987 by X Limited to the Inland Revenue Department which asserted that the Taxpayer's normal hours of work were from 9 a.m. to 5:30 p.m. (Saturday 9 a.m. to 1 p.m.), he was entitled to two weeks leave, that the company provided him with certain equipment (including a telephone line and an extension line) and that the Taxpayer was not required to hire any persons to help him discharge his work. Save for the matter of his working hours he did not disagree with any of the foregoing and confirmed that though he was entitled to holiday leave he had not taken any.

1.4.2 He acknowledged that when he was absent from the office his secretary, his assistant or his wife, who also worked at X Limited, would take messages on his behalf. He agreed that his wife used the same equipment as himself and was remunerated in a similar fashion to himself. His share of commissions was paid directly by X Limited into his bank account. Finally he acknowledged that he did receive a copy of the employer's return for 1985/86 (refer paragraph 1.1.4 above).

1.4.3 The Taxpayer further confirmed that notwithstanding the 1989 employer's return the nature of his work with X Limited, the manager and with whom he worked and all other material aspects were the same for that year as for previous years. He produced his name card which made no reference to Company A but showed him personally as a senior vice president and confirmed that the telephone, telex and fax numbers shown were X Limited's – not his own. He acknowledged that he was not the only person capable of accepting orders from his clients and others did so in his absence, namely his assistant, his secretary and his wife and further acknowledged that sometimes X Limited would take orders without passing them through himself. He conceded that his clients did not know Company A and that they believed they were placing orders with X Limited. He confirmed that he did not have any source of income apart from buying and selling stocks in his personal capacity which was the only source of income under the name of Company A (other than the commission income which is in issue). He agreed he did not introduce clients to other broker firms.

1.5 In re-examination, he denied that he had any strict working hours. He claimed that he commenced business as Company A in April 1985 even though he did not file his application for registration until 27 May 1986. He maintained that he had approached someone in X Limited and put forward a proposition that he was not an employee of X Limited. It would seem that because that person took no exception to this proposal he then filed the business registration application. When he received his salaries tax assessment for 1985/86 (refer paragraph 1.1.4 above) he asked the head of his department to have X Limited amend its employer's return but at that time X Limited declined to do so. However they

subsequently agreed to show Company A in their employer's return for 1989. He couldn't explain why X Limited agreed at this late stage to accede to his earlier request but believed that the personnel manager had made a mistake in not agreeing to amend the earlier employer's returns, possibly because the manager was unaware of his situation.

2. SUBMISSIONS

The submissions of the Commissioner's representative, Mr Wong Yui-keung, are reproduced at length separately below because we consider them to be more than usually helpful. The Taxpayer's representative made no further submissions.

3. REVENUE'S SUBMISSIONS BY THE COMMISSIONER'S REPRESENTATIVE

Mr Wong began by saying that if the commission represents income from employment then it is correctly charged. If however it represents income derived from the carrying on of a trade, profession or business of a commission agent or independent contractor then it should be charged to profits tax. (As the percentage of tax for the Taxpayer is the same, the distinction between the two heads of charge lies in the more liberal deduction of expenses applicable to profits tax, refer sections 12(1)(a) and 16(1). The Taxpayer in submitting a return for Company A – on or after 2 April 1987 – put his deductible expenses at $124,880 of which $80,000 related to entertainment).

He then went on to address us upon the law distinguishing contracts of service (which is to say the normal employer/employee relationship) and contracts for services (that is, agencies, sub-contractors and the like).

Contract of Service v Contract for Services

(1) In the case of Fall v Hitchen (49 TC 433 at page 439), the Vice-Chancellor pointed out that the expression 'contract of service' is coterminous with the expression 'employment'. An employee is under a contract of service for the performance of duties to his employer whereas a self-employed works under a contract for services as an independent contractor.

(2) The distinction between the employed and the self-employed is a fine one and over the years three broad tests have evolved from a line of authorities, viz: the control test, the integration or organization test and the economic reality test.

(a) Control test

The existence of a master and servant relationship is a very positive indicator of employment. A servant will normally be under the control of his master as to when and how he is going to perform his duties.

However this test has been found to be inadequate in modern times, especially in the case of an employee hired to perform highly skilful work. Thus in Market Investigations Ltd v Minister of Social Security [1969] 2 QB 173 Cooke J said (at page 185):

> '… control will no doubt always have to be considered, although it can no longer be regarded as the sole determining factor.'

(b) Integration or Organization Test

This consideration is actually a test to see whether the services a person performs for another are integral to that other's business. If the services performed are part of the main business of that other person, then there is strong indication that the person engaged for the work is under a contract of service. This principle was expounded by Lord Justice Denning in Bank Voor Handel v Slatford [1952] 2 All ER 956 at page 971:

> 'The test of being a servant does not rest nowadays on submission to orders. It depends on whether a person is part and parcel of the organization.'

This test was applied in a previous Board of Review decision, Case No D19/78, IRBRD, vol 1, 323.

(c) Economic Reality Test

The third consideration is whether the person performs the services as a person in business on his own account. The inherent features of a person in business on his own account are many and include the following:

(i) He provides his own equipment.

(ii) He hires his own helpers.

(iii) He assumes a certain degree of financial risk.

(iv) He undertakes certain degree of responsibility for investment and management.

(v) He has opportunity of profiting from sound management in the performance of his duties.

This test was first explicitly stated in the judgment in Market Investigations and applied in Fall v Hitchen and the Board of Review decision Case No D67/87, IRBRD, vol 3, 97.

4. CONCLUSION

Having regard to the facts set out above, the testimony of the Taxpayer and the documentary evidence put before us we can find no merit in this appeal or the totality of the submissions made on the Taxpayer's behalf. In many instances the Taxpayer's testimony severely undermined the grounds of appeal. The only conceivable factor in the Taxpayer's favour was the business registration but having been backdated even that was doubtful: in any case the remaining evidence was overwhelming against the possibility that the commission was derived from that business – indeed there is no extrinsic evidence whatsoever that the Taxpayer actually carried on that business, whether at the material time or at all. The two employment letters and all the other indications, such as place of work, provision of materials by X Limited, name card, customers' understanding and billing are clearly indicative of a contract of service. We have no hesitation therefore in finding as a matter of fact that during the basis period for the year of assessment 1985/86 the Taxpayer was an employee and the commission was exclusively derived from that employment. Accordingly this appeal is dismissed.

We do not believe that this case calls for a weighty analysis on our part of the reasons for reaching this conclusion, we have however very largely adopted the rationale set out in the submissions of the Commissioner's representative and applied them to the facts and evidence.

This appeal is therefore dismissed.