Case No. D76/00

Salaries tax – section 68(4) of the Inland Revenue Ordinance (' IRO') – onus of proof – whether an employment income arose in or was derived from Hong Kong – two-contract arrangement – interpretation of the facts – tax-consideration motivation.

Panel: Robert Wei Wen Nam SC (chairman), Douglas C Oxley and Horace Wong Ho Ming.

Date of hearing: 23 June 2000.
Date of decision: 25 October 2000.

Company B was a company incorporated in Hong Kong. Company E did not have a place of business in Hong Kong but was a company belonging to the same group of companies as Company B. Company G was established as an equity joint venture in China by Company E and its Chinese entities in 1994. A few times a year, Company B provided support in handling matters like administering payment of salaries for Company G as service to Company E and charged back all expenses to Company E.

In 1995, the taxpayer was offered two contracts for the same post of deputy general manager of Company G, one with Company G and the other with Company B. During the year of assessment 1996/97, the taxpayer stayed in Hong Kong for a total of 62 days, out of which he worked for seven days in Hong Kong. Both contracts were executed on the same day and were only valid together and could only be terminated at the same time. The taxpayer' s evidence is that such an arrangement was necessary because Company G refused to pay the whole amount of the salary and Company E had to pay a major part of it.

The taxpayer contends that his income should not be chargeable to salaries tax because his employment was offshore, save in so far as it was derived from seven days' services rendered in Hong Kong.

Held:

1. In deciding whether an employment income arose in or was derived from Hong Kong, the place where the services are rendered is not relevant to the enquiry. It is necessary to look for the place where the income really comes to the employee. The Commissioner may need to look further than the external or superficial features of the employment. He may need to examine other factors

that point to the real locus of the source of income, the employment. ' Totality of facts' test is descriptive of the process and that so called test embraces the place where the services were rendered or otherwise introduces irrelevant matters that it becomes impermissible (CIR v Geopfert [1987] 2 HKTC 210 applied).

2. It is expected that in the great majority of cases the question of Hong Kong or non-Hong Kong employment will be resolved by considering only the three factors, namely, the place where the contract of employment was negotiated, entered into and enforceable; the residence of the employer; and the place of payment of remuneration. However the Department must reserve the right in appropriate cases, to look beyond those factors. The situations in which further factors will have to be examined cannot be laid down with precision.

3. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.

4. Although the Board found that the Company B contract was negotiated, entered into and enforceable in Hong Kong and the taxpayer' s employment income was paid in Hong Kong, there are other relevant facts and circumstances concerning the employment to show that Company B was never really paid for the employment of the taxpayer nor did Company B employ the taxpayer to work for itself or for its benefit. The Board accepted the evidence of the taxpayer on the two-contract arrangement. Company B was functioned as a paymaster or accountant. The Board found a compelling inference that it was the intention of the parties concerned that the two contracts should create one and the same employment with Company G the joint venture and that that employment was located outside Hong Kong.

5. Given a true factual basis, the question becomes one of whether the taxpayer' s interpretations are correct. But the point is: whether his interpretation be correct or incorrect, the taxpayer is entitled to argue and interpret the facts, and no question of tax-consideration motivation can arise.

Appeal allowed.

Cases referred to:

CIR v Geopfert [1987] 2 HKTC 210
D146/98, IRBRD, vol 13, 693

Fung Chi Keung for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Nature of appeal

1. This is an appeal against the salaries tax assessment for the year of assessment 1996/97 raised on Mr A the Taxpayer. He contends that his income should not be chargeable to salaries tax because his employment was off-shore, save in so far as it was derived from seven days' services rendered in Hong Kong.

Facts not in dispute

2. The Taxpayer was married and had a daughter. His family resided in Hong Kong. At all relevant times, he owned three properties in Hong Kong.

3. Company B was a company incorporated in Hong Kong in 1985. It maintained an office in Kowloon. Mr C was the managing director of Company B.

4. Company B belonged to a group of companies with its headquarters in Country D. Company E was a company belonging to the same group of companies. Its managing director was Mr F. Company E did not have a place of business in Hong Kong.

5. Company B was Company E's marketing company in Hong Kong. Company B handled sales and service of Company E's products in Hong Kong, Taiwan and China.

6. In 1993 Company E was looking for a partner in China and they asked Company B to help them as Company B knew China much better.

7. In 1994, Company B and a Chinese entity set up an equity joint venture (Company G) in Province H of the PRC. Company E and its Chinese partner respectively contributed 55% and 45% to the registered capital of Company G. Mr F was chairman of the board of directors, and Mr C was a director, of Company G.

8. A few times a year, Company G would ask Company B for support in handling certain matters for Company G, such as booking of hotels and tickets for Company E's staff to travel to Company G via Hong Kong, translation of private discussions between shareholders, helping recruiting senior staff for Company G and administering payment of their salaries. Company B did all these as a service to Company E and charged back all expenses to Company E.

9. In 1994, as soon as Company G was established, Company E sent a staff member from Country D to Company G to be stationed there as the deputy general manager of Company G. The Chinese partner considered the salary of that staff member too high. As a compromise, Company G paid a portion of the salary and Company E paid the rest.

10. Around the end of 1995, the staff member from Country D wished to go back to Country D and Company E tried to employ someone from Hong Kong to replace him. Company E asked Company B to help them recruiting a replacement and making arrangements for payment of salary and pension and control of annual leave.

11. In or around November 1995, the Taxpayer was interviewed in Hong Kong successively by a recruiting agency engaged by Company B and Mr F, for the vacancy. The outcome of these interviews was successful.

12. The Taxpayer was offered two contracts for the same post of deputy general manager of Company G, one with Company G (the Company G contract) and the other with Company B (the Company B contract). The Company G contract carried a monthly salary of RMB9,000 (subject to a withholding tax) while the Company B contract provided for a monthly salary of $45,000 as well as a maximum year-end bonus of $300,000. The contracts were under cover of a letter dated 10 November 1995 and written by Mr C to the Taxpayer, stating: ' Both contracts shall be only valid together and can only be terminated at the same time.'

13. The Taxpayer' s evidence is that Mr C explained to the Taxpayer that the two-contract arrangement was necessary because Company G refused to pay the whole amount of the salary and Company E had to pay a major part of it.

14. The Company G contract was dated 24 November 1995 and was signed by the Taxpayer in Hong Kong. It was signed on behalf of Company G by Mr F as chairman of the board of directors and Mr C as a member of the board of directors. It stated that the Taxpayer was employed by Company G in the capacity of deputy general manager of Company G with effect from 1 December 1995 for an indefinite period unless it was terminated by three months notice and that in the performance of his functions, the Taxpayer should be based in Town I, PRC, subject to relocation to such other location as might be specified by Company G. It set out his remuneration at a monthly gross salary of RMB9,000, withholding taxes, reimbursements of expenses, housing and transportation. Other terms and conditions related to such matters as leave, holidays and vacation, confidentiality and termination. It provided that payment of the salary should be made to a bank account designated by the Taxpayer and that the contract should be governed by and construed in accordance with the laws of Hong Kong.

15. The Company B contract was also dated 24 November 1995 and also signed by the Taxpayer in Hong Kong. On behalf of Company B, it was signed by Mr C as managing director of

Company B. It stated that the Taxpayer would be employed as deputy general manager of Company G, that the place of work would be in Town I of Province H, subject to being employed elsewhere, that he would receive a monthly gross salary of $45,000 in 13 payments per annum, plus a year-end bonus of a minimum $140,000 and a maximum $300,000, that his salary would be transferred to his bank account at the end of each month and that the Taxpayer was required to keep the amount of his remuneration confidential. Other provisions included insurance and pension, holiday, agreeing holiday period with competent superior at the beginning of the calendar year, secrecy, etc. It stated that the contract should be valid as from 1 December 1995 and continue for an indefinite period unless it was terminated by three months notice.

16. During the year of assessment 1996/97, the Taxpayer stayed in Hong Kong for a total of 62 days, out of which he worked for seven days in Hong Kong.

17. The Taxpayer ceased employment on 31 December 1999 in accordance with the provisions in the Company B and Company G contracts.

The relevant law

18. In deciding whether an employment income arose in or was derived from Hong Kong, Macdougall, J stated in CIR v Geopfert [1987] 2 HKTC 210 at page 236:

> ‘ *... the place where the services are rendered is not relevant to the enquiry ... It should therefore be completely ignored.’*

and 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).’*

and at page 238:

> ' *... the cases show that there was no consistency of approach adopted by variously constituted Boards of Review. It seems probable that the totality of facts test has been interpreted differently by different Boards. It is only when that so called test embraces the place where the services were rendered or otherwise introduces irrelevant matters that it becomes impermissible.'*

19. The Inland Revenue Departmental Interpretation & Practice Notes, Note 10, paragraph 6 states:

> ' *It is expected that in the great majority of cases the question of Hong Kong or non-Hong Kong employment will be resolved by considering only the three factors [namely, the place where the contract of employment was negotiated, entered into and enforceable; the residence of the employer; and the place of payment of the remuneration]. However, the Department must reserve the right, in appropriate cases, to look beyond those factors. As was pointed out in the Goepfert decision: [here the paragraph cites the passage beginning with the words "There can be no doubt" – see para 18 above].*
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> *The situations in which further factors will have to be examined cannot be laid down with precision ...'*

20. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.

Findings and reasons

21. It is easy to point at the following three features of the Company B contract and say, ' Here you have an employment located in Hong Kong' :

(1) The Company B contract (that is, the contract for payment, or the contract for employment) was negotiated, entered into and enforceable in Hong Kong.

(2) Company B the employer was a company incorporated in Hong Kong and maintained an office in Hong Kong.

(3) The majority of the Taxpayer' s employment income was paid in Hong Kong.

22. The argument set out in the preceding paragraph is flawed by failing to give sufficient consideration to other relevant facts and circumstances concerning and surrounding the employment, particularly the following:

22.1 At all times the Company B contract and the Company G contract co-existed. They were executed on the same day, were ' only valid together' and could only be, and were, terminated at the same time (see paragraph above).

22.2 We find that all outgings and expenses paid by Company B under the Company B contract, including payments to the Taxpayer, such as salary, were charged back to Company E the Country D shareholder in Company G the joint-venture. Thus Company B never really paid for the employment of the Taxpayer as the deputy general manager of Company G.

22.3 Nor did Company B employ the Taxpayer to work for itself or for its benefit. In fact, in all his four years of employment, the Taxpayer only worked for Company G and never rendered any service to Company B. He reported his work to the general manager of Company G and also to the directors of Company G and mainly to Mr F, chairman of Company G and managing director of Company G. He did not report his work to Company B. Before 1998, he reported his work to Mr C the managing director of Company B but only because Mr C was a director of Company G. We accept the Taxpayer' s evidence relevant to these matters. There is some evidence (which was not denied by the Taxpayer) that he reported ' disciplinary' to Mr C, managing director of Company B. We take the view that such reporting was only a matter of formality.

22.4 The two-contract arrangement was the result of an agreement between the Chinese and Country D shareholders in Company G the joint-venture that Company G should pay part of the remuneration of the Taxpayer, but that Company G the Country D shareholder should pay the majority of it (see paragraph 13 above). We accept the Taxpayer' s evidence on this aspect because it rings true and fits in with the way the remuneration was provided by the two contracts (see paragraph 12 above). We find that Company B only functioned as a paymaster or accountant to make it possible for the Taxpayer to take up his post of deputy general manager of Company G in China under the two contracts.

22.5 A compelling inference from the letter covering the two contracts (see paragraph 12 above) is that it was the intention of the parties concerned that the two contracts should create one and the same employment with

Company G the joint venture and so we find.

23. Taking all the above factors, features, facts and circumstances into consideration (save and except the place where the Taxpayer rendered his services or performed his duties), we have no hesitation in saying that the Taxpayer had only one employment with the joint venture and that that employment was located outside Hong Kong.

Shifting ground?

24. A point was raised by Mr Fung the Commissioner's representative during his final submission that the Taxpayer has been shifting his case by asserting initially employment with Company B, then employment with Company E and finally employment with Company G. Mr Fung voiced suspicion that such changes to his case might have been motivated by tax considerations and he suggested that little weight should be placed on the Taxpayer's claims that his employer was Company E or Company G.

25. (1) On 24 November 1997 the assessor raised on the Taxpayer the salaries tax assessment under appeal. On 15 December 1997 the Taxpayer lodged an objection to the assessment which was in the following terms:

> '... as I have been working full time in China in Company G since January 1996 and has no income from any service provided in Hong Kong, I shall be eligible for exemption for salary tax.'

(2) On 22 May 1998 the assessor informed the Taxpayer in writing, inter alia, as follows:

> '... remuneration received by employees of Hong Kong companies are fully assessable to Hong Kong salaries tax. The fact that you were sent to work in China did not automatically exempt you from liability ...'

(3) On 4 August 1998 the Taxpayer replied, stating, inter alia

> 'Although my employment contract is signed with Company B, actually I am employed by Company G for:
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> 1. The managing director of Company G Mr F was the one who interviewed me and offered me the job.
>
> 2. I do not carry out any service for Company B. I only work for Company E to manage its joint venture Company G.

3. My salary is firstly paid by Company B but then charged back to Company E.

4. I come to HK only for (1) holidays, (2) Board meetings, which for convenience was sometimes held in HK and (3) reporting duty to one of the directors of Company G – Mr C who is also the managing director of Company B. I never do any work for Company B.

Therefore, the company of Company E is my actual employer.

Since I am employed by a of Country D company of Country D (in actual) I should be exempted from paying HK salaries tax.'

26. At the hearing of this appeal the Taxpayer, both in evidence and in submission, mentioned for the first time the Company G contract and asserted that in substance, he had only one employment and that that employment was with Company G. He had not referred to the Company G contract earlier, because he did not realise its importance until he read D146/98 and found out that it had 'a lot of similarity' with this case. He then re-formulated his case.

27. The Taxpayer changed the identity of his employer twice – from Company B to Company E to Company G – by putting alternative interpretations on the facts. Mr Fung very properly conceded that the Taxpayer was honest with the facts. Given a true factual basis, the question becomes one of whether the Taxpayer's interpretations are correct. But the point is: whether his interpretations be correct or incorrect, the Taxpayer is entitled to argue and interpret the facts, and no question of tax-consideration motivation can arise.

Decision

28. It follows that this appeal succeeds and that the salaries tax assessment in question is hereby annulled save that the Taxpayer's income derived from seven days' services rendered in Hong Kong in the basis period for the year of assessment 1996/97 be assessed to salaries tax, both parties to be at liberty to apply to the Board for directions if necessary.