Case No. D79/97

Salaries tax – employment – locality of contract of employment – locality of payment of salary – locality of employer – whether liable to salaries tax on full income – section 8 of the Inland Revenue Ordinance.

Panel: Ronny Tong Ka Wah SC (chairman), David Lam Tai Wai and David A Morris.

Date of hearing: 19 September 1997.
Date of decision: 19 September 1997.

The taxpayer was employed by an overseas company (The Company) as the director of operations in Region B. He was based mainly in Hong Kong and, in 1990/91, spent 229 working days in Hong Kong. The Company filed a tax return in respect of the taxpayer declaring HK$542,880 to be his full salary for 1990/91. The Commissioner rejected the taxpayer's contention that his assessable income should only be HK$340,601 on the basis that he was employed outside of Hong Kong and had spent only 229 days in Hong Kong that year. The taxpayer appealed to the Board.

Held:

The taxpayer was employed to look after the Company's business in Region B from its operational base in Hong Kong. The Company has a local management based in Hong Kong, the authorized representative to which the taxpayer is required to directly report. Moreover, the taxpayer was paid his salary in Hong Kong. The Board was satisfied that the taxpayer's income in question derived from Hong Kong. Consequently, he was liable to be assessed on his full income of HK$542,880. Accordingly, the taxpayer was unable to discharge his burden under section 68(4) of the Inland Revenue Ordinance.

Per Curiam: Where the taxpayer chooses not to attend the hearing before the Board, justice would be better served if any written submissions handed to the Board by the representative of the Commissioner were also sent to the taxpayer. The taxpayer would then be able to send his reply submissions, if any, to the Board in advance of the hearing.

Appeal dismissed.

Cases referred to:

Bennet v Marshall 22 TC 73

Foulsham v Pickles 9 TC 261
Bray v Colenbrander 34 TC 138
CIR v Goepfert [1987] 2 HKTC 210

Chan Tak Hong for the Commissioner of Inland Revenue.
Taxpayer in absentia.

Decision:

The Facts

1. The Taxpayer was employed by a company from Country A ('the Company') in December 1989 as director of operations, Region B. His duties were, *inter alia*, as his designation suggests, to oversee the Company's operations in Region B. He was based mainly in Hong Kong. In the tax year which concerns us, namely, 1990/91, he spent 229 working days in Hong Kong.

2. The Company filed a tax return in respect of the Taxpayer for 1990/91 and gave the following details:

Position held: Director of Operations, Region B

Period of employment: 1 April 1990 to 31 March 1991.

Salary/wages: $542,880

Whether the employee was wholly or partly paid by an overseas concern either in Hong Kong or overseas: No.

3. The Taxpayer, however, in his salaries tax return for the year of assessment 1990/91 contended that his assessable income should only be $340,601 on the basis that he was employed outside of Hong Kong and he only worked 229 days in Hong Kong.

4. By a determination dated 22 November 1996, the Commissioner of Inland Revenue ('the Revenue') rejected the Taxpayer's objection to an assessment based on the full amount of his salary. The Taxpayer now appeals to this Board.

5. The Taxpayer chose not to appear before us at the hearing nor did he instruct his representative/accountant to attend. Instead, full written submissions were sent to this Board and the Revenue. At the hearing, we were informed by the Revenue that there was certain oral communication between the Revenue's representative and the Taxpayer's representative. We were satisfied that the Taxpayer and his representative must be aware that oral submissions would be made by the Revenue at the hearing but chose not to attend the hearing. In the circumstances, we proceeded to hear the appeal in the absence of the

Taxpayer. However, we wish to remind the Revenue that in future, the interest of justice will be better served if any written submission to be handed in by the Revenue can be sent to the Taxpayer or his representative in advance to ensure that any reply to such submission can be sent in by the Taxpayer or his representative in the event he chooses or they choose not to appear.

The Relevant Statutory Provision

6. The relevant statutory provision which calls for our consideration is section 8 of the Inland Revenue Ordinance, Chapter 112 ('the IRO') which reads as follows:

> *'(1) Salaries tax shall, …, 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 attributable to such services;*
>
> *(b) excludes income derived from services rendered by a person who --*
>
> *(i) …*
>
> *(ii) renders outside Hong Kong all the services in connection with his employment …' (emphasis added).*

7. A careful reading of the aforesaid provisions suggests that the key element to be identified is the source of income as opposed to the location of employment. The statute does not speak of any employment of profit *in Hong Kong* but any income arising in or deriving from Hong Kong from *any* employment of profit. This is fortified by paragraph (a) of subsection (1A). One would have thought that paragraph is hardly necessary if the incidence of tax depends solely on a local employment. That paragraph conceivably must be introduced to catch income derived from services rendered in Hong Kong under a foreign employment. Conversely, paragraph (b) of subsection (1A) is necessary to give relief to employees who work out of Hong Kong (subject to the provision set out in subsection (1B) thereof) under a local employment.

8. Within this tax regime, a person is liable for salaries tax if he is employed in Hong Kong but renders some of his services out of Hong Kong. This is completely in line with common sense. Let us take the example of a foreign domestic maid who signed her contract of employment in say, Country C. The contract of employment was made overseas but she came to Hong Kong and worked full time in Hong Kong. She must be undoubtedly liable for salaries tax for everything she earned while working in Hong Kong.

9. Let us then take the example one step further; say she was required by her employer to accompany the employer's children occasionally to Country D. Can it be said that she earned part of her salary not in Hong Kong but in Country D? We think not. She was asked, as part of her job in Hong Kong, to perform certain duties out of Hong Kong. The salary she earned as a result of that arrangement was earned in Hong Kong, or to use the language of the section: her income arose in or was derived from Hong Kong even though her services were not rendered in Hong Kong.

10. We are relieved to find that this common sense approach is in line with the approach of the Court. In Bennet v Marshall 22 TC 73, Sir Wilfrid Greene MR said (at page 92):

> 'The language, [in Foulsham v Pickles 9 TC 261], it seems to me, quite clearly establishes the proposition that the place where the work is carried out is not a matter to which attention should be directed. If I am right in my view as to the effect of Pickles v Foulsham, it has the result in this case that the test for ascertaining the source of income is to look for *the place where the income really comes to the employee, …*' (*emphasis added*).

While we cannot agree that the place where the work is carried out is always irrelevant in view of the language of the Hong Kong statute, we think the concept that the source of income is 'the place where the income really comes to the employee' is certainly one which is in line with the approach of the local tax regime.

11. Another member of the Court of Appeal in Bennet v Marshall, Romer LJ, put the matter in even plainer terms:

> 'The House of Lords … in Foulsham v Pickles have definitely decided that, in the case of an employment, the locality of the source of income is not the place where the activities of the employee are exercised but the place either where the contract for payment is deemed to have a locality or where the payments for the employment are made, which may mean the same thing.'

12. The case of Bennet v Marshall was expressly approved by the House of Lords in Bray v Colenbrander 34 TC 138. These authorities were carefully considered and followed by Macdougall J in CIR v Goepfert [1987] 2 HKTC 210.

13. 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. Bearing these matters in mind, we now turn to the submissions of the Taxpayer.

The Taxpayer's Submissions

14. The Taxpayer, through his representative, makes essentially 3 points:

(a) The contract of employment was made in Country E;

(b) The employer was a company from Country A and was resident in Country A and not Hong Kong;

(c) The place of payment was purely fortuitous and is 'a relatively less important factor'.

15. Let us consider each of these submissions carefully and in the same order as it is raised.

Locality of Contract of Employment

16. We are prepared to assume that the contract was negotiated in Country E. There is no independent evidence, however, that it was signed in Country E. The letter of appointment dated 5 December 1989 was written on the Company's Hong Kong office letterhead bearing a Hong Kong address. It was certainly signed in Hong Kong by a Mr F, the 'vice president, Region B' of the Company. It is clear from the documents (nor is it in dispute) that the Company was a foreign company registered in Hong Kong under Part XI of the Companies Ordinance, Chapter 32 and Mr F was the 'authorised representative' of the Company in Hong Kong.

17. The Taxpayer's representative submitted that it should be apparent that the place of enforceability of the contract would be in Country A, as the employment was offered by the Company which was a corporation from Country A. We do not agree. The letter of appointment is very specific on the area of work of the Taxpayer. In the second paragraph of the letter it is said that the Taxpayer would be 'located in [the Company's] Region A office in Hong Kong and will report directly to [Mr F]'; that the Taxpayer was to be responsible for all operational activities in the entire Region B. Plainly, it was envisaged that the contract was to employ the Taxpayer to look after the Company's business in the region from its operational base in Hong Kong.

18. Our view is further reinforced by the fact that the Company did file a tax return in Hong Kong and in its letter of 29 October 1996 admitted that all salaries were paid to the taxpayer in Hong Kong and treated such payments as the Company's expenses in Hong Kong. Without a doubt, the locality of the contract for the payment of salary was in Hong Kong.

Locality of the Employer

19. Nor do we agree that the employer here is not resident in Hong Kong. The Company is a locally registered company under the Companies Ordinance, Chapter 32. It has its place of business here. It obviously pays tax here. It has a local management which oversees its operation in this region based in Hong Kong. It follows that the Company has a place of residence here.

20. The Taxpayer's representative submitted that the Taxpayer was 'neither under the management control of the Hong Kong representative office, nor subject to its supervision in carrying out his duties'. There is, however, no evidence to support this contention. What evidence there is, points to the contrary: the letter of appointment makes it clear that the Taxpayer was to report directly to Mr F. In the Company's letter dated 29 October 1996, it is said that Mr F was the 'authorised representative' of the Company in Hong Kong. The Taxpayer, therefore, was certainly under the management control of a representative, if not *the* representative, of the Hong Kong office. The master and servant relationship must, therefore, be based in Hong Kong.

Locality of Payment

21. It is then said that the place of payment of salaries was entirely fortuitous and of 'less importance'. We cannot agree. The authorities reviewed by us above point quite the other way.

22. It is further said that while the operation of the medical insurance scheme was in Hong Kong, the retirement fund scheme was operated and provided direct by the head office. We cannot accede to this submission either. There is no such evidence. On the other hand, the benefit statement put before us suggests that the retirement scheme was based on a 'Hong Kong Dollar Guaranteed Fund'. Clearly, the place of enforcement of that scheme is Hong Kong.

23. This is further supported by the letter of appointment which speaks of the 'base salary' in Hong Kong dollars is to cover the Taxpayer's services rendered 'in and outside Hong Kong'. Later on, the letter continued: 'you and your family will be covered by the medical insurance we operate in Hong Kong.'

Conclusion

24. In these circumstances, we cannot see how it can be argued that the locality of the employment is anywhere other than in Hong Kong. The Taxpayer has not discharged his burden under section 68(4) of the IRO and his appeal must be dismissed.