KPMG

Hong Kong (SAR) Tax Alert

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Salaries Tax – Time-apportionment basis

Summary

On 6 December 2023, the Court of First Instance ("CFI") handed down its decision in the case of *Randeep S Grewal v Commissioner of Inland Revenue*[1]. The CFI dismissed the taxpayer's appeal and held that the taxpayer's employment in the concerned years of assessment was not a non-Hong Kong employment and therefore his employment income should not be assessed on a time-apportionment basis.

Background

- Company A was incorporated and registered in the Cayman Islands. Its shares were listed on the Alternative Investment Market ("AIM") of the London Stock Exchange. Its principal activities were acting as a holding company and providing financing and management services to its subsidiaries.
- Company A's board of directors comprised of the Taxpayer, being the only executive director, and 4 other non-executive directors.
- In the Director's Report for the years ended in the relevant years, Company A disclosed that the principal activities were carried on from its principal place of business in the Hong Kong (SAR). In the Chairman's Statement in the same report, the Taxpayer, as the Chairman, stated that Company A had its headquarters in Hong Kong.
- During one of the concerned years, the Taxpayer and Company A entered into an Executive Employment Agreement, under which the Taxpayer took the role of Chairman and Chief Executive Officer ("CEO") of Company A.
- The Inland Revenue Department ("IRD") initially allowed the time-apportionment claims lodged by the Taxpayer, but rejected them after further enquires and issued various additional assessments and revised assessments to the Taxpayer.
- The Taxpayer appealed to the Board of Review ("the Board"). The Board dismissed the appeal and upheld the IRD's position that the central management and control of Company A was Hong Kong, and therefore Taxpayer's income in the concerned years of assessment was chargeable for Salaries Tax under section 8(1) of the Inland Revenue Ordinance ("IRO").
- The Taxpayer appealed to the CFI against the decision of the Board. Central to the questions of law framed was the correctness of *CIR v Goepfert [1987] HKLR 888*, followed and applied in *Lee Hung Kwong v CIR [2005] 4 HKLRD 80*, on the interpretation of Section 8 of the IRO. Specifically:
    - Question #1: the proposition that Goepfert, and Lee Hung Kwong which applied and followed, were wrongly decided in concluding that the place where the employee services are rendered is not relevant to the enquiry under section 8(1) the IRO.

1 The CFI judgment can be accessed via this link to the Judiciary website.

- Question #2(1): the Board's decision was incorrect in law by failing to recognize and apply the a "two-limbed approach" adopted and followed by both Goepfert, and Lee Hung Kwong, whereby the location of the employment is the place of payment (unless a sham).
- Question #2(2): the Board erred in law in failing to conclude that the employer in the present case (Company A) was resident in London not Hong Kong, whose corporate activities were all carried out in London (due to its being a non-trading holding company with an AIM listing in London), and central management and control was in London.

The Decision

For Question #1, the CFI agreed with the interpretation of section 8(1) that "the place where the employee's services are rendered is not relevant to the enquiry" as it was supported by a proper interpretation of the IRO as a whole, and in particular by the wording, structure, context, purpose and legislative history of the provisions.

The Judge in the Goepfert case concluded that the place where the services are rendered was not relevant to the enquiry under section 8(1) as to whether income arises in or is derived from Hong Kong from any employment, and that section 8(1A)(a) creates a liability to tax additional to the basic charge which arises under section 8(1). The CFI confirmed that the Judge in the Goepfert case, Deputy Judge in the Lee Hung Kwong case, and the Board did not misconstrue the charging section and have not applied the incorrect legal test.

For Question #2(1), the CFI do not accept that the language and structure of section 8 of the IRO admits of the adoption of the "two-limbed approach", nor do the authorities support the existence of the approach.

For Question #2(2), the CFI agreed with the Board's decision that Company A's central management and control was in Hong Kong, based on the following findings:

- Company A's principal activities were acting as a holding company and providing financing and management services to its subsidiaries;
- Some administration for Company A was carried out in Hong Kong as evidenced by various documents such as the 2010 Announcement, the 2010 Notice of AGM, the minuted attendance/participation of certain personnel in the Board meetings, the statements made in the some of the concerned years' annual reports of Company A that the Hong Kong address was the principal place of business of Company A;
- The place where the company A's most significant assets were at least in part in Hong Kong;
- It was publicized that Company A's principal place of business was in Hong Kong, as shown in the annual reports, the audited financial statements, and the 2009 Announcement and the 2010 Notice of AGM;
- Insofar as the two principal activities of Company A were concerned, on the evidence before this Board, Hong Kong was the location where part of the financing services for the subsidiaries and the provision of management services to the subsidiaries were carried out;
- The executive director, Chairman and CEO of Company A, the Taxpayer, was resident in Hong Kong. His residence was also decisive of the ascertainment of the location of Company A's most significant assets, the entrepreneur or executive director who sought business opportunities and presented them to the Board and the provider of management services of Company A to its subsidiaries;

As a result, the CFI agreed with the Board's decision and dismissed the Taxpayer's appeal.

KPMG Observations

This CFI confirms in this decision the Salaries Tax liability of Hong Kong located employment is governed under section 8(1) where that of a non-Hong Kong employment arises under the extension to the basic charged in section 8(1A), which is consistent with the prevailing interpretation and practice.

It also provides guidance on the factors to be considered when determining the location of central management and control of a company incorporated and registered outside Hong Kong. This may serve as a reference to taxpayers with an employer in similar set up when considering the location of their employment and chargeability of Salaries Tax on their employment income.

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