

HONG KONG TAX ALERT

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Corporate residence determines source of director's fees

A recent Board of Review decision on the taxation of a director's fees involved an investigation into the corporate residence of the company paying the fees.

Highlights

- The source of a director's fees is determined by the location of the company residence
- Corporate residence usually determined by where central management and control of company is exercised
- Tests previously used to determine the source of director's fees may no longer apply in the modern corporate environment
- A broader range of facts need to be examined to reach the appropriate determination

The Hong Kong Board of Review (hereafter referred to as "the tribunal") recently had to decide whether fees earned by a director of a company incorporated offshore but listed in Hong Kong were subject to salaries tax in Hong Kong ([D21/13](#)).

In this case, the taxpayer was an independent director of a public company ("the company") that was incorporated outside of Hong Kong but had its primary stock exchange listing in Hong Kong.

The company was a pure holding company, with its assets comprising holdings in subsidiaries (and loans to those subsidiaries) situated in mainland China.

In return for his services to the company, the taxpayer received a fee which he contended was not subject to taxation in Hong Kong on the grounds that his director's fee was sourced outside of Hong Kong as his duties were performed outside the territory.

Under Hong Kong salaries tax principles, the source of a director's fees is determined by the place where the office of director is located, and not where their duties are actually performed. The office of director is, in turn, located where the company is resident. Both parties to the appeal accepted the principles but differed on the determination of that location.

In the absence of a statutory definition of company or corporate residence, reliance was placed on, mainly, English court decisions that concluded that a company's residence is where the real business is carried on, and the real business is carried on where its central management and control are exercised.

Consequently, the outcome of the taxpayer's appeal depended on whether the central management and control of the company was exercised either within or outside Hong Kong.

Central management and control is an established test to determine the residence of companies and has been widely adopted around the world (in Asia this includes Hong Kong, India, Malaysia and Singapore). In Hong Kong, determining where central management and control is situated generally includes a consideration of all the circumstances in which the company carries on business, including (but not necessarily limited to):

- where directors meet and where they are resident
- the company's objects clause
- the place of incorporation
- where the real trade and business is carried on
- where books are kept and administration is carried on
- the location of significant assets.

Furthermore, in applying the test to a non-trading company (such as a pure holding company), the actual nature of the company's corporate activities may be more important.

Ultimately, locating where a company's central management and control is exercised is a question of fact, and each case will be decided based on its own facts.

A frequent starting point in the enquiry is to examine whether the central management and control of a company is exercised by the directors in board meetings. If it is, then the locality will be where those meetings are held. In this particular case, the enquiry was inconclusive as the overview of the board meetings was confusing. This was due to the fact that some meetings were held in Hong Kong and others in mainland China, where the majority of directors were resident, and most meetings had directors joining by telephone with their physical location unknown. Thus, the taxpayer's argument that the board meetings were held in mainland China (and that was the location of the central management and control of the company) was not upheld by the tribunal.

The tribunal then examined other relevant factors in order to determine where the company's management and control lay. It concluded that this was in fact in Hong Kong.

In reaching its conclusion, the tribunal referred to the following determinative facts:

- The company was registered in and had an address in Hong Kong.
- The company's shares were listed on the Hong Kong Stock Exchange.
- The company's main activities were to maintain its listing on the Hong Kong Stock Exchange and to leverage the Hong Kong banking and financial infrastructure in order to obtain finance.
- Some of the directors' meetings and all the annual general meetings of shareholders were held in Hong Kong.
- Bank accounts were held by the company in Hong Kong.
- The company employed staff and had its financial accounts audited in Hong Kong.

Therefore, having determined that the company was resident in Hong Kong, irrespective of whether it may be resident elsewhere too, the tribunal concluded that the source of the director's fees was Hong Kong and therefore subject to taxation.

The straight-forward tests previously used to determine the source of director's fees may no longer immediately apply in the modern corporate environment and the location of board meetings cannot be automatically assumed to be where central management and control of a company is exercised. Nowadays, where companies are able to organize their activities globally and in various different ways, no single test can be used to decide on the residence of a company and instead, a broader range of facts need to be examined to reach the appropriate determination.

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