Hong Kong Institute of
Certified Public Accountants
香港會計師公會

14 June 2005

By fax (2877 1082) and by post

Our Ref.: C/TXG, M35392

Mrs. Alice Lau Mak Yee-ming
Commissioner of Inland Revenue
Inland Revenue Department
36/F, Revenue Tower
5 Gloucester Road
Wanchai, Hong Kong

Dear Mrs. Lau,

Re: Departmental Interpretation and Practice Notes No. 10
Charge to Salaries Tax

At the annual meeting between the Institute and the Inland Revenue Department ("IRD"), you invited the Institute to submit comments on the existing Departmental Interpretation and Practice Notes No. 10 ("DIPN10"), which was issued on 1 December 1987, following the decision in the High Court case of *Commissioner of Inland Revenue (CIR) v Goepfert ("Goepfert")*. Our Taxation Committee has considered the DIPN and we set out below our comments on the existing DIPN10 and its application.

Preamble

Before setting out our comments on the specific implications of DIPN10 we would point out that one of the major advantages of Hong Kong's taxation system has been its simplicity and certainty. Where there is uncertainty in Hong Kong's tax legislation this is potentially damaging to Hong Kong. It is of considerable importance to the future of Hong Kong, and for its reputation as a financial centre, therefore, that any such uncertainty be removed, either by a clear statement of departmental practice that is consistently followed and applied by officers of the IRD, or by amendments to the Inland Revenue Ordinance ("IRO").

The current DIPN10 is an example of a practice note the introduction of which removed a significant area of uncertainty in the interpretation of the IRO.

Prior to the decision in *CIR v Goepfert ("Goepfert")*, there had been two previous versions of DIPN10.

The first was issued on 10 June 1974 and it adopted a "totality of facts test" in dealing with the basic charge to salaries tax and the determination of whether income arose in or was derived from Hong Kong. That version of DIPN10 listed six factors, which comprised the "totality of facts test".

4th Floor, Tower Two, Lippo Centre,
89 Queensway, Hong Kong
香港金鐘道89號力寶中心二座四樓
Tel 電話 : (852) 2287 7228
Fax 傳真 : (852) 2865 6776
(852) 2865 6603
Web 網址 : www.hkicpa.org.hk
E-mail 電郵: hkicpa@hkicpa.org.hk

That version remained in force until 30 January 1982, when it was replaced by a slightly more comprehensive version of DIPN10; but in Part 1 – "Basic Charge – Employment", the same six factors were retained, and only the introduction to the tests was changed.

The totality of facts test led to considerable confusion regarding the application of sections 8(1) and 8(1A) of the IRO and in 1980s the confusion and uncertainty in this area of our tax law led to a significant backlog of cases at the Board of Review. There was also a lack of continuity in decisions, with different factors being stressed by the taxpayer and the IRD in different cases. The result was an unsatisfactory state of affairs, which was detrimental to Hong Kong's reputation as a financial centre.

The matter finally came to the attention of the courts in Hong Kong in the *Goepfert* case. The decision in *Goepfert*, as discussed further below, drew upon the decisions in three UK cases and identified three fundamental tests to determine the source of income for salaries tax purposes.

Following that decision, the then CIR, Mr Anthony Au-Yeung, issued the current version of DIPN10 on 1 December 1987. This version of DIPN10, which, in our view, is based on a clear and correct understanding of the decision in the *Goepfert* case, restored certainty to this area of the law. As a result, in a short period of time most of the outstanding cases regarding the source of employment were settled and the backlog at the Board of Review was cleared by applying the three tests set out in paragraphs 3 and 4 of DIPN10 ("the *Goepfert* tests") with the withdrawal of some cases and confirmation of the position in other cases. Officers of the IRD and taxpayers and their representatives worked together to rapidly clear the backlog of disputed cases.

Thus the importance of the three *Goepfert* tests, set out in the existing DIPN10, as a means of reintroducing certainty in the area of the determination of source of employment income cannot be overstated.

<u>Recent Developments</u>

It is unfortunate, therefore, that in recent years officers of the IRD appear have been departing from reliance on the three *Goepfert* tests set out in Part A of DIPN10. In addition, determinations have been issued which include statements that are seemingly inconsistent with the wording of DIPN10. An example of this would be the use of tests to identify the place where an employer is resident. This has generated considerable uncertainty and even a public perception that specific factors are being stressed, although they may be quite remote, which would be less likely to support a time claim.

Even if it were to be accepted that the totality of facts test, applied in the earlier versions of DIPN10 (see Appendix 1), was the correct means of determining the source of employment (and the *Goepfert* decision suggests otherwise), it should be pointed out that, currently, tests which some assessors have applied as important factors do not seem to be relevant to the matter in hand.

Examples of factors that have been relied upon would include the fact that the taxpayer observes Hong Kong public holidays and that his family is based in Hong Kong.

Moreover, the departure from the three *Goepfert* tests set out in DIPN10 has again led to considerable uncertainty in relation to this important area of our legislation and taxpayers are no longer able to rely on the implementation of the practice and law as reflected in DIPN10.

At the time that the current version of DIPN 10 was issued on 1 December 1987, the notes on the front page stated the following, which made it clear that the CIR was setting out the IRD's interpretation of the position after the *Goepfert* case:

> *"These notes contain a summary of the Departmental Interpretation and Practice and are issued for the information and guidance of taxpayer. They have no binding force and do not affect a person's right to objection or appeal to the Commissioner, the Board of Review or Courts."*

Whilst we note that DIPNs are simply the CIR's interpretation and are not binding upon taxpayers, we consider that taxpayers may reasonably expect that, where a DIPN has been issued and the taxpayers have complied with it, the IRD will ensure that staff of the department apply the interpretation reflected in that practice note. (As an aside, it is not clear why the wording of the text on the front of DIPNs was subsequently changed, but we consider that the previous version was clearer and more informative.) Practitioners have serious concerns that this does not appear to be true in some cases relating to matters covered by DIPN10. We believe there is an urgent need for the IRD to establish a clear, consistent and accurate application of DIPN10, if certainty is to be restored to this area of our legislation.

Against this background, we set out below our comments on specific sections of the DIPN10.

<u>Commentary on Existing DIPN10</u>

Part A Basic charge – Employments

Paragraph 2 of the existing DIPN10 is very important and, in so far it is relevant, reads as follows:

> *"For many years the Department has taken the view, based on decisions of the Board of Review, that it is the totality of the facts of each case which determines whether income from employment arises in or is derived from Hong Kong with no one factor having an overriding influence on the question. However, the question of source and place of employment was recently before the High Court in CIR v Goepfert [Inland Revenue Appeal 5 of 1986]. After reviewing a number of decisions of the Board of Review the Court concluded that the test of source of employment income could be drawn from a series of English cases and can be summarised by the*

> *question; where does the income really come to the employee, in other words, where is the source, the employment, located. Furthermore, while in answering this question it is necessary to look at a number of factors, the Court was firmly of the view that the place where the services are rendered by the employee is not a factor which can properly be taken into account. It also follows from the judgement of the Court that other factors, such as the nature of the employee's duties and whether his remuneration forms part of the expenses of a Hong Kong company or establishment, which the Department has previously taken into account will not often have relevance to the question of place of employment."*

This is a clear statement of the IRD's position and, in our view, the then CIR was correct in his interpretation of the *Goepfert* decision. There has been no subsequent Hong Kong court decision overruling the *Goepfert* decision and accordingly his views are still valid.

In paragraphs 3 and 4 of the DIPN, the CIR proceeded to set out the tests applied in the *Goepfert* case, based on UK case law. These were:

(a) the place where the contract of employment was negotiated and entered into, and is enforceable;

(b) the place where employer is resident; and

(c) the place where the employee's remuneration is paid to him.

In our view, the comments set out in paragraphs 2, 3 and 4 of DIPN10 are correct and demonstrate that the CIR had read and understood, not only the decision in the *Goepfert* case, but also the decisions in the three English cases on which the *Goepfert* case was based.

It is unfortunate, therefore, that in some recent Board of Review decisions, the board has once again referred to and relied upon the totality of facts test.

--- We set out in Appendix 2 the detailed rationale for our view that the current practice note was correct at the time of issue. Moreover, it follows that, in the absence of a ruling of a higher court in Hong Kong (as opposed to decisions of various Boards of Review) the position of the CIR at the time of issue of the existing DIPN, and the use of the three tests based on the *Goepfert* decision, continues to reflect the existing law and to remain valid.

--- We set out in Appendix 3 our analysis of the confusion that exists regarding the totality of facts test.

In our view, therefore, Part A of the existing DIPN10 is correct, with the exception of paragraph 7, which covers a transitional arrangement that no longer applies and should be deleted from the practice note.

We would urge the IRD to reissue DIPN10 retaining existing paragraphs 1 to 6 and paragraph 8, which, we maintain, reflects the correct interpretation of the *Goepfert* decision.

There are, however, two areas where Part A requires some clarification.

(i) The second *Goepfert* test set out in paragraph 4(b) states:

> *"In considering this matter the term "resident" will be given its ordinary meaning. In this context a corporation will be regarded as being resident outside Hong Kong if it has its central management and control outside Hong Kong. The employer for this purpose is the person who, in the relationship of master and servant, is the master of the employee."*

We note with considerable concern that, in applying this test, it appears that some officers of the IRD are not following the position set out above and, instead, have now introduced a new concept, which we consider to be unrelated and questionable, of whether the employer has "a place of residence" in Hong Kong. This is not the test in the *Goepfert* case or the relevant UK cases, and it is not the test provided for in DIPN10.

A foreign company that has its central management and control in another jurisdiction is resident in that jurisdiction. If it establishes a branch in Hong Kong, it will have a place of residence in Hong Kong, as it will have an office in Hong Kong. However this does not mean, under accepted English and Hong Kong law, that the company is resident in Hong Kong. We consider that an error has arisen in this area (and this new test has been stated in determinations issued by the IRD to taxpayers), which should be rectified. We consider that the test set out in DIPN10 (i.e., the place where a company is resident is determined by central management and control) should be reinforced in a new DIPN10 and followed consistently by the IRD.

(ii) Paragraph 6 requires revision, to make clear the circumstances in which additional factors should be applied, to identify those factors and to stress that they are to be used in determining the answers to the three fundamental tests and not as additional factors ranking equally with, or outweighing, the three fundamental tests set out in the *Goepfert* case and the UK case law. DIPN10 should stress that these factors will only be used where the answers to the three fundamental tests appear to have been manipulated and are not self-evident. The practice note should set out what additional factors will be applied to each of the three *Goepfert* tests. As set out in the *Goepfert* decision, these additional factors should be limited to the totality of facts test, referred to in Appendix 1.

Part (B) Extension Of Charge – Employments

This section, which comprises existing paragraphs 9 to 11 does not, in our view, require any significant amendment.

Part (C) Exclusion From Charge – Employments

Paragraphs 12 to 14 remain correct. However, given the increasing number of queries regarding the application of the so-called "60-day rule" (see section 8(1A)(b) of the IRO, read in conjunction with section 8(1B) IRO) this section should be expanded to set out a definition of "visits" and a definition of a "day" for the purposes of the 60-day test.

Part (D) Directors Fees

Whilst paragraph 15 is considered to be correct, there is increasing uncertainty as to the definition of control and management and how this is to be determined. This section should be expanded, therefore, to set out in more detail the IRD's view on what constitutes "central control and management", and how the locality of that "central control and management" is to be determined, as this has a direct impact upon the taxability of directors' fees. As indicated in our comments on Part A above, this also has an impact upon the question of where the employer is resident in test (b) in paragraph 4 of the DIPN.

Part (E) Ship and Aircraft Personnel

We believe that no adjustment is required.

Part (F) Exclusion – Tax Paid Outside Hong Kong

We consider that this section remains applicable and no significant adjustment is required.

<u>Additional matters for inclusion in new DIPN10</u>

We believe the opportunity should be taken in the review of DIPN 10 to clarify the IRD's views with respect to the following:

- The treatment of salaries tax paid by employers in the case of non-Hong Kong employment, and confirmation of the position that salaries tax paid in such circumstances is itself an assessable benefit that cannot be apportioned as part of the time claim;

- the treatment of per diem expenses in respect of days where services are provided outside Hong Kong in cases of non-Hong Kong employment. This is the opposite of the position in relation to salaries tax paid, and we understand that such per diem expenses are treated as not taxable and not apportionable;

- the calculation of days out of Hong Kong in the case of single day visits to other jurisdictions, including the Mainland, where there is a non-Hong Kong-source employment, to reflect the IRD's practice that a half-day relief is given for such trips; and

- "incidental" services for the purposes of section 8(1A)(b) IRO.

Conclusion

We consider that the existing DIPN10 is substantially correct, that the CIR's interpretation of the decision in the *Goepfert* case (and the decisions in the three English cases on which it was based) at the time the DIPN was issued, was, and remains, fundamentally correct and that his adoption of the three *Goepfert* tests also remains correct.

This being the case, we believe that these tests should be restated and be applied consistently by the IRD. In conjunction with this there should be some clarification of paragraphs such as 4(b), 12 to 14 and 15.

We do not believe that the totality of facts test, as adopted prior to the *Goepfert* case, or the questionable additional factors now being adopted by some officers in the IRD, are correct or supported by case law. We would reiterate that there has been no decision of the higher courts that has cast doubt on the *Goepfert* decision. Accordingly any comments by the Board of Review in a particular case cannot be taken as authority for overriding the *Goepfert* decision and the three tests formulated therein, which are correctly stated in paragraphs 3 and 4 of DIPN10.

We would suggest that this matter is of fundamental importance to the determination of source of employment in Hong Kong and the need for certainty in this area of our legislation. In our view, if it cannot be satisfactorily clarified by reissuing DIPN10 based on the three *Goepfert* tests, as set out in paragraphs 3 and 4 of the existing DIPN, and derived from the leading cases (i.e., the decisions in *Goepfert* and in the UK tax cases set out in Appendix 2), then the only alternative may be to seek amendment of IRO to incorporate a definition of Hong Kong-and non-Hong Kong-source employment, and thus restore certainty through legislative means.

Yours sincerely,

Peter Tisman
Director, Specialist Practices

PMT/JT/ay
Encls.

Appendix 1

Departmental Interpretation and Practice Notes No. 10

Totality of Facts Test applied before the *Goepfert* case

(1) The place where the contract, whether verbal or written, is enforceable;

(2) The exact nature of the taxpayer's duties and identification of what he is remunerated for;

(3) Whether the taxpayer serves or holds office in, or has employment with, a Hong Kong company, organisation or establishment in Hong Kong of a non-resident business;

(4) Who remunerates the taxpayer – where the cost of this remuneration or of his service is ultimately borne;

(5) Whether the remuneration or cost forms ultimately or directly part of the expenses or cost of a Hong Kong company or establishment;

(6) Whether the duties performed by the taxpayer during temporary absences from Hong Kong are incidental to his employment or office in Hong Kong or completely distinguishable from that role.

Appendix 2

Departmental Interpretation and Practice Notes No. 10 ("DIPN10")

The Charge to Salaries Tax

Section (A) Basic Charge - Employments

When considering Departmental Interpretation and Practice Notes (DIPN) No.10 by far the most attention is directed at section (A) "Basic Charge – Employments", which comprises eight paragraphs. This is currently the most contentious part of DIPN10 because of the increasing emphasis placed by assessors on matters other than the three fundamental tests described below. Any consideration of the existing DIPN10 and in particular paragraphs 1 to 8 of the existing DIPN10, contained in Section A, should have, as a starting point, a consideration of the history of this practice note and a review of the decision in *CIR v Goepfert*.

Law

The relevant law is contained in sections 8(1) and 8(1A) of the Inland Revenue Ordinance (IRO).

History

The history of DIPN10 is as follows:

On 10 June 1974 the Inland Revenue Department (IRD) issued the first DIPN10, which adopted the so-called "totality of facts" test in dealing with basic charge to salaries tax in the determination of whether income arose in or derived from Hong Kong. The Commissioner of Inland Revenue (CIR) noted that the Board of Review had specifically rejected the IRD's claim that the place where a contract of employment is signed was a deciding factor. It had also discounted the currency in the place in which the salary was paid. The Board took into account the six factors reproduced in Appendix 1.

This DIPN10 remained in force until 30 January 1982 when it was replaced by a slightly more comprehensive version; but in "Part 1 Basic Charge – Employments", the same six factors were retained and only the introduction to the tests was changed. There was no significant difference between the first two versions of DIPN10 in respect of the determination of source of employment.

However, the application of the totality of facts test led to considerable confusion and uncertainty with a resulting backlog of cases at the Board of Review. There was also a lack of continuity in the decisions with different factors being stressed by taxpayers and the IRD.

Matters finally came to the attention of the courts in Hong Kong in the case of *CIR v Goepfert*. Following the decision in that case, DIPN10 was revised and the existing version of DIPN10 was issued on 1 December 1987. The section entitled

"Basic Charge - Employments" contains eight paragraphs, which are based on the three factors that were fundamental to the decision in the *Goepfert* case.

Change of Approach by the CIR – the three *Goepfert* Tests

Paragraph 2 of the existing DIPN10 is extremely important and reads, in so far it is relevant, as follows:

> *"For many years the Department has taken the view, based on decisions of the Board of Review, that it is the totality of the facts of each case which determines whether income from employment arises in or is derived from Hong Kong with no one factor having an overriding influence on the question. However, the question of source and place of employment was recently before the High Court in CIR v Goepfert [Inland Revenue Appeal 5 of 1986]. After reviewing a number of decisions of the Board of Review the Court concluded that the test of source of employment income could be drawn from a series of English cases and can be summarised by the question; where does the income really come to the employee, in other words, where is the source, the employment, located. Furthermore, while in answering this question it is necessary to look at a number of factors, the Court was firmly of the view that the place where the services are rendered by the employee is not a factor which can properly be taken into account. It also follows from the judgement of the Court that other factors, such as the nature of the employee's duties and whether his remuneration forms part of the expenses of a Hong Kong company or establishment, which the Department has previously taken into account will not often have relevance to the question of place of employment."*

This was a fundamental change in the approach of determining the source of employment.

This was a clear statement of intention by the then CIR regarding the future application of sections 8(1) and 8(1A), IRO.

The CIR continued in paragraphs 3 and 4 to set out the tests that had been applied in the *Goepfert* case, based on UK case law ("the *Goepfert* tests"). These are:

(a) the place where the contract of employment was negotiated and entered into, and is enforceable;

(b) the place where employer is resident;

(c) the place where the employee's remuneration is paid to him.

In our view, paragraphs 2, 3 and 4 were correct when the current DIPN10 was issued and are still correct and in line with the decision in the *Goepfert* case.

UK Case Law

In the *Goepfert* case, MacDougall J referred to three major cases, namely:

Pickles v Foulsham	9TC261(1925)
Bennet v Marshall	22TC73(1937)
Bray v Colenbrander	34TC138 (1953)

MacDougall J drew heavily on these three decisions in his judgement.

He quoted as follows, from Sir Wilfrid Greene in *Bennet v Marshall*:

> *"In my opinion if there is one thing that [Foulsham v Pickles] did, it was entirely to negative the proposition that the locality of the employment depended upon the place where the employment was in fact carried on."*

MacDougall J stated, at Page 237 of the Goepfert case:

> *"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 Wilfrid Greene said, regard must first be had to the contract of employment."*

In *Pickles v Foulsham*, Lord Buckmaster stated:

> *"The source of his income was the money paid by an English company into an English bank in pursuance of an agreement for service made in this country [UK]."*

It was held that the source of the income was in the UK.

Here we see quite clearly the three tests, which were adopted by MacDougall J and set out in DIPN10, being used in determining the source of income.

In *Bennet v Marshall*, Mackinnon L J stated:

> *"The contract under which the Respondent was employed was made in Ohio; his remuneration arising from that contract was paid to him in Canada by remittance from Ohio.*
>
> *There is only one factor in regard to his employment that is relied on for an argument that the source of his income from his employment was in the United Kingdom and not abroad, and that factor is that some, or perhaps most, of the work that his employment required him to do was done in the United Kingdom. Again, I remind myself in this connection that the fact that he is residing here is, for this purpose, immaterial."*

In *Bennet v Marshall*, Mackinnon L J adopted Lord Buckmaster's tests as follows:

> *"The source of his income was the money paid by an American company into a Canadian Bank in pursuance of an agreement for service made in America."*

It was held that the source of the income was outside the UK.

Thus, in *Bennet v Marshall,* the three tests adopted in the *Goepfert* case set out in DIPN10 were used to determine the source of income.

The three tests were also adopted, in *Bray v Colenbrander,* by Lord Normand. In *CIR v Goepfert*, MacDougall J quoted from Lord Normand's decision as follows:

> *"My Lords, in each of these appeals the Respondent entered into a contract of employment with an employer resident abroad. The contract was in each case entered into in the country of the employer's residence and it provided for payment of the employee's remuneration in that country."*

In all three authorities relied upon in the *Goepfert* case, the same three tests were used.

These were the tests used by MacDougall J in the *Goepfert* decision.

The advent of certainty

These three tests were incorporated into the current DIPN10 as set out above.

The adoption of these three tests in the majority of cases restored a significant degree of certainty to the determination of source of employment, so that taxpayers and the IRD were able to settle the vast majority of outstanding cases quickly. This played a significant part in resolving the large backlog of Board of Review cases dealing with source of employment under sections 8(1) and 8(1A). These tests were clearly correct based on UK case law and a careful reading of the *Goepfert* decision.

Totality of Facts

It will be seen from paragraph 2 of DIPN10 that the totality of facts test previously expounded in earlier versions of DIPN10 was discredited by the *Goepfert* decision.

However, in paragraph 6 of the existing DIPN10, the CIR refers to a statement by MacDougall J at page 237 of the decision in the Goepfert case. This comment by MacDougall J is based on the decision of Lord Normand, at page 155 of *Bray v Colenbrander*, and is quoted by McDougall at page 237 of the *Goepfert* case. The quotation is reproduced below:

> *"My Lords, in each of these appeals the Respondent entered into a contract of employment with an employer resident abroad. The contract was in each*

case entered into in the country of the employer's residence and it provided for payment of the employee's remuneration in that country."

"Parenthetically it should be said that there is no suggestion that the place of payment was nominal or pretended, or that the real or genuine place of payment was not the place specified in the contract. Nothing, therefore of what follows in this opinion in any way touches a case where the designated place of payment is challenged as nominal or pretended and unreal."

The second part of the above quotation has been seized upon by some members of the Board of Review, and subsequently by some assessors, as evidence that a totality of facts test should still be used in the majority of cases. They quote as authority the following comment by MacDougall J:

"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)."

However, in this paragraph, MacDougall J was referring to the position where the information required to answer the three tests set out in the three English cases, and followed by MacDougall J in the *Goepfert* case, was not clear. It is important to note that MacDougall J was referring to Lord Normand's quotation that the additional factors would only be considered where the three factors and, in particular, the place where payments was made, were challenged as nominal or pretended or unreal.

In DIPN10, this is recognised in paragraph 6 which states:

"It is expected that in the greater majority of cases the question of Hong Kong or non Hong Kong employment will be resolved by considering only the three factors mentioned above."

In recent years, the limited caveat adopted by Lord Normand has, in our view, been applied incorrectly by some members of the Board of Review. This is discussed in more detail in Appendix 3.

Appendix 3

Departmental Interpretation and Practice Notes No. 10 ("DIPN10")

The Charge to Salaries Tax

Totality of facts test - The Reintroduction of Uncertainty

Paragraph 6 of DIPN10 quite clearly states:

> *"It is expected that the greater majority of cases the question of Hong Kong or non Hong Kong source employment will be resolved by considering only the three factors mentioned above. However the Department must reserve the right, in appropriate cases, to look beyond those factors".*

This is based on the comments of MacDougall J, at page 237 of the *Goepfert* case:

> *"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 Wilfrid Greene said regard must firstly had to the contract of employment.*
>
> *This does not mean that the Commissioner may not look beyond the appearances to discover the reality. The Commissioner is not bound to accept as conclusive any claim made by the employee in this connection. He is entitled to scrutinise all the evidence, documentary or otherwise, as it is relevant to this matter."*

MacDougall J's authority for this was the comments of Lord Normand at page 155 of *Bray v Colenbrander* where, referring to the three basic tests now set out in paragraph 4 of DIPN10, he commented as follows:

> *"My Lords, in each of these appeals the Respondent entered into a contract of employment with an employer resident abroad [Test 2]. The contract was in each case entered into in the country of the employer's residence [Test 1] and it provided for payment of the employee's remuneration in that country [Test 3]. Parenthetically it should be said that there is no suggestion that the place of payment was nominal or pretended, or that the real or genuine place of payment was not the place specified in the contract. Nothing, therefore of what follows in this opinion in any way touches a case where the designated place of payment is challenged as nominal or pretended and unreal."*

Lord Normand's comments made it clear that the three tests should be applied unless there was evidence that the three tests had been manipulated and did not reflect the true facts of the case and that the tests could be "challenged as nominal or pretended and unreal".

MacDougall J then went on to say that, in deciding the crucial issue, where the three tests <u>are</u> "nominal or pretended and unreal", 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 source of the income, the employment."

Expanding on this MacDougall J went on to say that where the position is considered to be "nominal or pretended and unreal", so that other factors need to be reviewed:

> *"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 those tests."*

This makes it clear that where the arrangements are considered to be "nominal or pretended and unreal" and only then:

(a) additional factors are to be reviewed to ascertain the true answers to the three "*Goepfert*" tests in paragraphs 3 and 4 of DIPN10; and

(b) the additional factors to be considered are these contained in the totality of facts test set out in the two previous versions of DIPN10 (see Appendix 1).

It will be noted that these six factors or tests, as set out in Appendix 1, do not include the following items, which have also been put forward by the IRD as evidence of a Hong Kong-source employment.

- The taxpayer's application for a Hong Kong visa was sponsored by the Hong Kong office (which was not a Hong Kong company). (Extract from a determination.)

- The contract provided that the taxpayer was based in Hong Kong and he was provided with quarters in Hong Kong. (Extract from a determination.) In *Bennet v Marshall* Mackinnon J L clearly stated that the place where the taxpayer resides is immaterial for this purpose (see Appendix 2).

- The taxpayer was allowed to follow Hong Kong public holidays.

These and similar matters are terms of the employment contract, and not factors that determine the source of the employment.

The reference to such considerations by officers of the IRD simply adds to the level of uncertainty, which has encouraged assessors to ignore the current DIPN10. Thus in one Board of Review case the CIR's representative argued that the three tests set out in DIPN10 could be disregarded and that "it was legitimate for the [IRD] to adopt the broader approach by applying the totality of facts test". The Board supported the CIR's representative in this claim and stated that it could find no justification to say that the totality of facts test had been disregarded in the *Goepfert* case. The Board stated:

> *"We are of the view that MacDougall J was in favour of the totality of facts tests in the process of determining the source of employment."*

As authority the Board referred to the comment by the Chairman of Board of Review, Mr Turnbull, in case D40/90:

> *"Apparently the Commissioner has promulgated tests to be studied when deciding if employment is located outside Hong Kong. We can find no direct justification for what the Commissioner has promulgated following the Goepfert decision".*

The same Board also stated that although the contract of employment was negotiated outside Hong Kong, as the expatriate had to obtain a work visa to work in Hong Kong, the contract of employment was only concluded when the Hong Kong branch of the overseas company submitted the application for a work visa to the Hong Kong Immigration Department.

The logical extension of the above comments by the CIR's representative and the Board in the above case is that no expatriate that requires a work visa to work for a Hong Kong branch of an overseas company will qualify for a time claim, which means, in effect, that section 8(1A) of the IRO is redundant. This is not the position adopted in the *Goepfert* decision, nor is it the position in the three UK cases, which formed the basis for the *Goepfert* decision.

The *Goepfert* case has not been overruled or set aside by a decision of a higher court in Hong Kong and, accordingly, as the IRD is bound by case law, officers of the IRD should follow what we believe to be the correct interpretation of the law set out by the CIR in the existing DIPN10.

The CIR was, therefore, correct in his analysis of the position in paragraph 6 that only where the answers to the three *Goepfert* tests, set out in paragraph 4 of DIPN 10, can be challenged as being "nominal or pretended and unreal" will the so-called "totality of facts" test be applied. Where there is no challenge to the three *Goepfert* tests, then those three tests should be applied, as set out in the *Goepfert* case and in the three UK court cases on which the *Goepfert* decision was based, as described in Appendix 2.