

Chapter 2

SALARIES TAX

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¶2-0050 Overview

Salaries tax is charged, under Pt 3 of the *Inland Revenue Ordinance* (“IRO”), on any income arising in or derived from Hong Kong from an office, employment or pension (section 8).

“Income” is defined in the *Ordinance*, but not exhaustively (see ¶2-0300). Consequently, common law principles need to be referred to for the purpose of determining whether a payment constitutes taxable “income” (see ¶2-1100). Certain income is specifically exempt from salaries tax: for example, the income of an employee who only visits Hong Kong for a short period of time (see ¶2-3700).

To be assessable to salaries tax, a taxpayer’s income must have been derived from an office, employment or pension. Certain factors indicate when an “office” or “employment” exists (see ¶2-2800 and ¶2-2850). The geographical source of a taxpayer’s income is crucial in determining whether he or she is liable to salaries tax since income which has not been derived from Hong Kong is not subject to Hong Kong tax.

See further ¶2-3000.

A taxpayer’s salaries tax liability is charged at the lower of progressive rates on net chargeable income and standard tax rate on net assessable income after concessionary deductions. The net chargeable income is arrived at by making various deductions from the taxpayer’s income as determined under the general charging and income definition provisions (sections 8 and 9) (see ¶2-4250). Deductions are made for allowable deductions, including outgoings and expenses (see ¶2-4950), self-education expenses (see ¶2-5300), depreciation and other capital allowances (see ¶2-6100), and losses (see ¶2-6150); concessionary deductions, including approved charitable donations (see ¶2-6450), elderly residential care expenses (see ¶2-6550), home loan interest (see ¶2-6700), and contributions to recognised retirement schemes (see ¶2-6900); and personal allowances (see ¶2-7050).

The *Inland Revenue (Amendment) (No. 8) Ordinance 2018* was enacted on 1 April 2019 to introduce a tax deduction for health insurance premiums under the Voluntary Health Insurance Scheme (VHIS) to taxpayers who are subject to salaries tax or who have elected personal assessment (see ¶2-7000). The tax deduction is effective from the year of assessment 2019/20.

The *Inland Revenue and MPF Schemes Legislation (Tax Deductions for Annuity Premiums and MPF Voluntary Contributions) (Amendment) Ordinance 2019* was enacted on 1 April 2019 to introduce tax deductions

for premiums paid to qualifying annuities and contributions made to tax deductible Mandatory Provident Fund voluntary contribution accounts to taxpayers who are subject to salaries tax or who have elected personal assessment (see ¶2-7020) commencing from the year of assessment 2019/20.

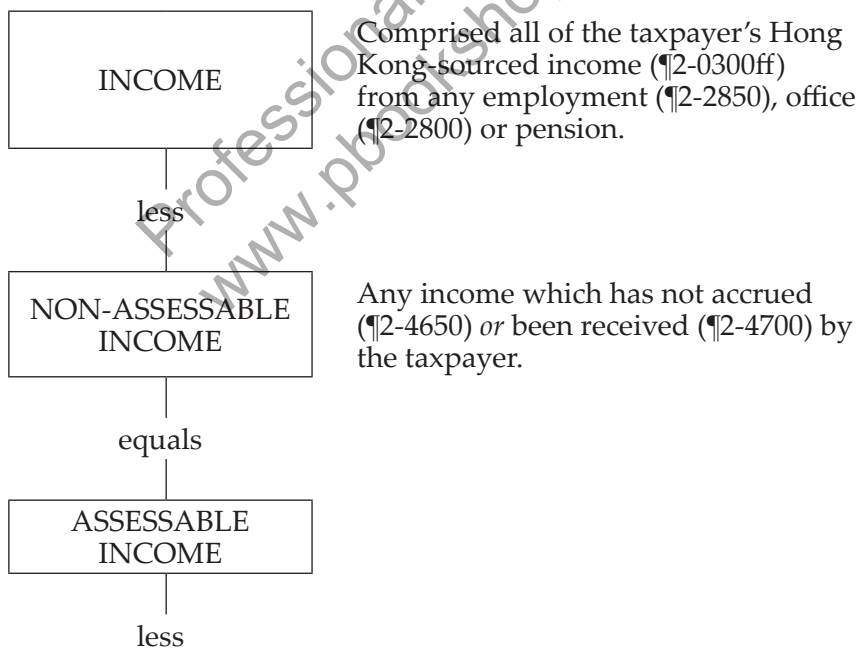
The *Inland Revenue (Amendment) (Tax Deductions for Domestic Rents) Ordinance 2022* was enacted on 30 June 2022 to provide for a tax deduction for eligible domestic rental expenses from the year of assessment 2022/23.

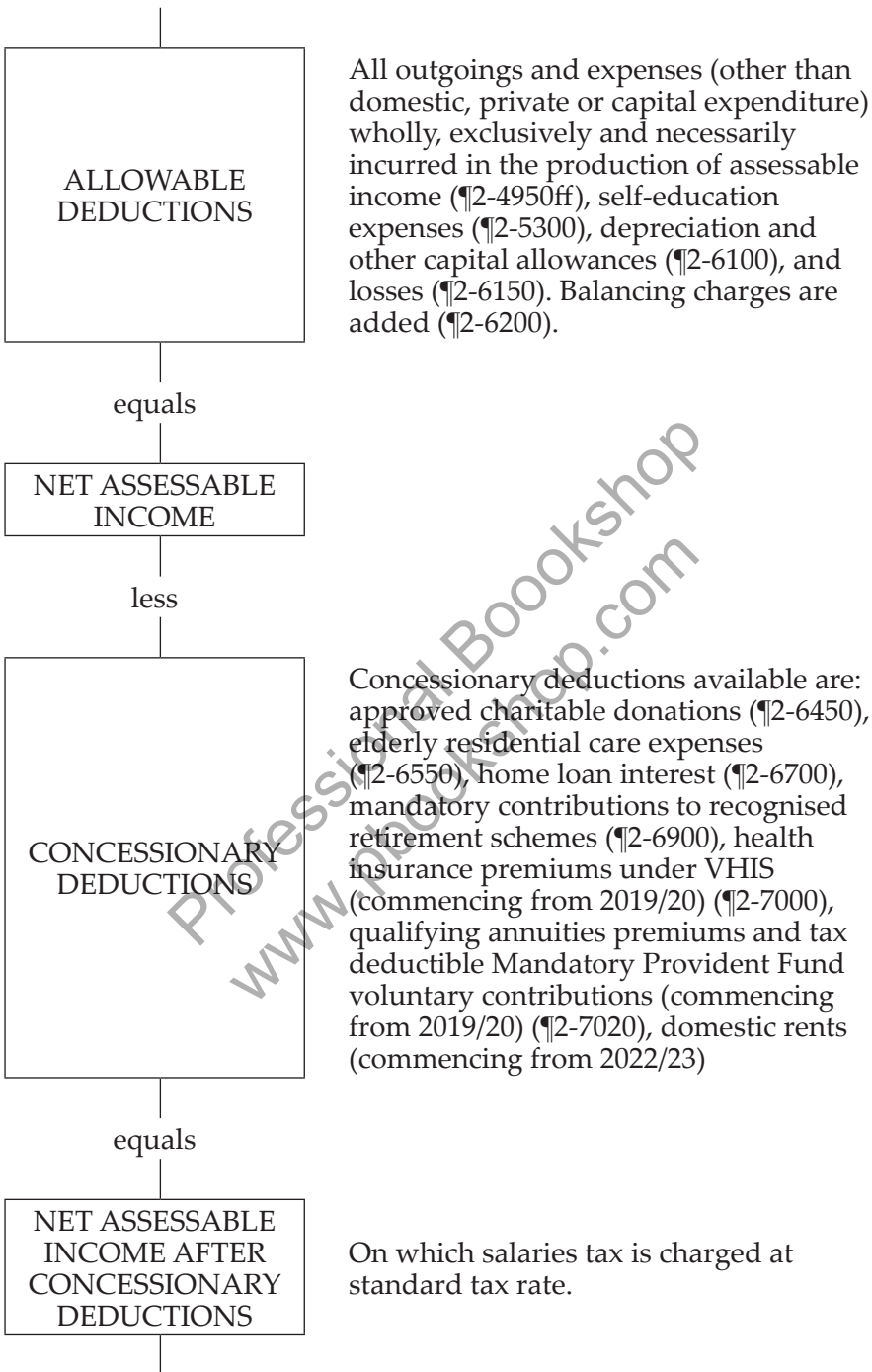
For more on the flowchart, refer to ¶2-0100.

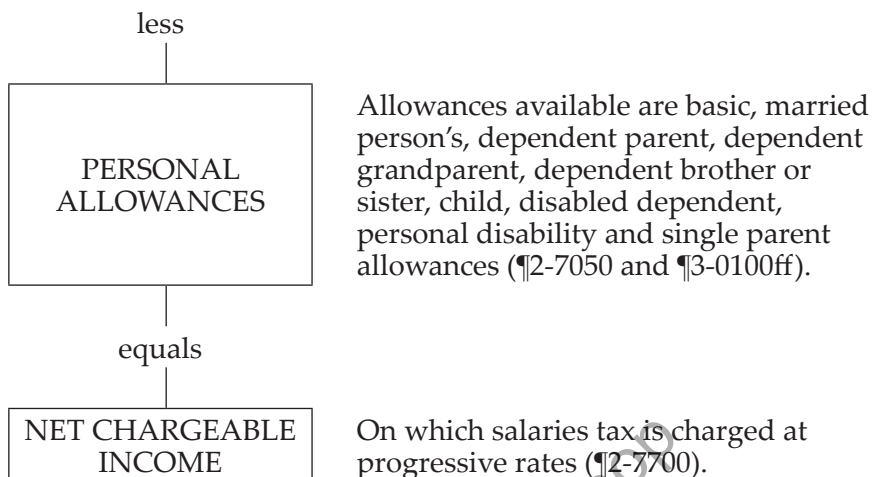
Every person who is liable to salaries tax is also liable to pay provisional salaries tax under Pt 10A of the *Ordinance* (refer to Chapter 10 at ¶10-8000ff).

¶2-0100 Flowchart

The following flowchart demonstrates the process by which a taxpayer's salaries tax liability is determined.







DEFINITION OF "INCOME"

¶2-0300 Statutory definition of "income"

The basic charging section for salaries tax (section 8) requires that salaries tax be charged on every taxpayer in respect of his or her Hong Kong-sourced office, employment and pension income. The *Ordinance* gives some aid in identifying payments which qualify as "income" for salaries tax purposes. It does not, however, provide an exhaustive definition of the term. "Income" is defined as including:

- wages;
- salaries;
- leave pay;
- fees;
- commissions;
- bonuses;
- gratuities;
- perquisites; and
- allowances (section 9(1)(a)).

These forms of payment qualify as "income" regardless of whether they are derived from an employer or some other person. They are discussed further at ¶2-1750.

Apart from the general definition, the following payments are specifically categorised as “income” under section 9 of the *Ordinance*:

- Any amount (other than a pension) received by an employee from a **pension or provident fund**, scheme or society (other than a recognised occupational retirement scheme or mandatory provident fund scheme) to the extent that it represents his or her employer’s contributions to the relevant fund, scheme or society (section 9(1)(aa); see ¶2-1950).
- Any amount (other than a pension) received by an employee from a **recognised occupational retirement scheme** other than on termination of service, death, incapacity, terminal illness or retirement, to the extent that it represents his or her employer’s contributions to the scheme (section 9(1)(ab)(i); see ¶2-1950).
- Any amount (other than a pension) received by an employee from a **recognised occupational retirement scheme** upon termination of service to the extent that it represents his or her employer’s contributions to the scheme in excess of the “proportionate benefit” permitted to be exempt under section 8(5) (section 9(1)(ab)(ii); see ¶2-1950).
- Any amount received by an employee, in accordance with a court order made under section 57(3)(b) of the *Occupational Retirement Schemes Ordinance* for **any shortfall** in the funding of a beneficiary’s benefits, to the extent that the amount is attributable to the employer’s contributions to the relevant occupational retirement scheme (section 9(1)(ac); see ¶2-1950).
- Any accrued benefit received or taken to have received by an employee from a **mandatory provident fund scheme** other than on retirement, death, incapacity, terminal illness or termination of service, to the extent that it represents contributions paid to the scheme by the employer (section 9(1)(ad); see ¶2-1950).
- Any accrued benefit received or taken to have received by an employee from a **mandatory provident fund scheme upon termination of services** to the extent that it represents voluntary contributions paid to the scheme by the employer in excess of the “proportionate benefit” calculated under section 8(5) (section 9(1)(ae); see ¶2-1950).
- The **rental value** of any residence provided rent free by an employer or an associated corporation (section 9(1)(b); see ¶2-2100).

- When a place of residence is provided by an employer (or an associated corporation) at a rent less than the rental value, the **excess of the rental value** over the rent paid (section 9(1)(c); see ¶2-2400).
- Any gain realised by the **exercise of, or by the assignment or release of, a right to acquire shares** or stock in a corporation if the right was obtained by virtue of the taxpayer's employment or office in that or any other corporation (section 9(1)(d); see ¶2-2600).
- Any **benefits provided by an employer not in connection with a holiday package and capable of being converted into money** by the recipient (section 9(2A)(a); see ¶2-1550).
- Any **education benefits** paid by an employer for the education of an employee's child (section 9(2A)(b); see ¶2-1600).
- Any amount paid by an employer to an employee in connection with a **holiday journey** (section 9(2A)(c); see ¶2-1630).

DEEMED EMPLOYMENT INCOME

¶2-0500 Remuneration paid to service company or trust

Remuneration paid to a service company for the services of an individual who controls the company, or whose associate or associates control the company, is deemed to be income derived by that individual from employment and is therefore brought within the charge to salaries tax under section 8. This is provided under section 9A. Remuneration paid to a trust of which the individual or an associate of the individual is a beneficiary is also deemed to be employment income under section 9A.

Section 9A applies to remuneration paid on or after 18 August 1995. The section was introduced to prevent the avoidance of salaries tax through service company arrangements which disguise employer/employee relationships.

The Inland Revenue Department ("IRD") has issued Departmental Interpretation and Practice Notes ("DIPN") No 25: Service Company "Type I" Arrangements, Salaries Tax, which sets out the practice it intends to adopt in relation to section 9A.

Deemed employment

Under “Type I” arrangements, the person paying the remuneration and the individual (the “relevant individual”) providing the relevant services under a service company agreement are treated as having an employer/employee relationship commencing either from 18 August 1995 (the date of commencement of section 9A) or from the day on which the individual commenced performing services, whichever is later (section 9A(1)(c)(i)(A)). The employment is treated as ceasing when the agreement terminates, *unless* the individual continues carrying on services as an employee, in which case the employment is regarded as continuing (section 9A(1)(c)(i)(B)).

The remuneration is treated as having been received by and accrued to the individual as employment income at the time that it is paid or credited to the service company or trust concerned (section 9A(1)(iii)).

The taxpayer in *Case M17* (2003) HKRC ¶80-882 (*D118/01 IRBRD Vol 16*) alleged that he was the sole proprietor of an architectural services firm which had been appointed to provide services to Company A. The income received from Company A had been assessed to estimated salaries tax following the taxpayer’s failure to furnish a salaries tax return. The taxpayer alleged that the income received belonged to the firm and as the sole proprietor, he should be assessed on the net business income which was much lower than the estimated salaries income assessed.

The Service Agreement evidencing the nature of the relationship between Company A and the taxpayer referred to the appointment of the taxpayer to the position of Director of Property Development. He had specified duties, annual leave and other employee benefits and was subjected to restrictions against him engaging in business outside the Company or in competition with the Company. The taxpayer’s testimony was not accepted that the income he received from Company A belonged to the firm. At the time the draft Service Agreement was prepared by Mr C, the chairman of Company A, the existence of the firm was known to Mr C. The contract would have been clear that it was contracting with the firm rather than with the taxpayer. The terms of the Service Agreement provided further support for the existence of an employer/employee relationship. See also *Case M80* (2003) HKRC ¶80-945 (*D43/02 IRBRD Vol 17*).

If the agreement under which the remuneration is paid is silent as to the amount of the remuneration to be paid, then any sum which is paid or credited to the service company or trust is deemed to be remuneration paid under the agreement, unless it is established that

it is not remuneration for the services carried out (section 9A(2)). When a service company agreement provides for services to be carried out by two or more relevant individuals and/or for payments to be made for purposes other than remuneration for services, it is advisable for the parties to make clear, whether in the agreement or otherwise, the amount of remuneration paid for the services of each relevant individual. Otherwise, each individual may be potentially liable to salaries tax in respect of the full amount paid to the service company (DIPN No 25 (Revised), para 20).

Notification requirements

When an employment relationship is deemed to exist under section 9A, the relevant person and the relevant individual who are deemed employer and employee, respectively, are required to fulfil all applicable notification and compliance requirements imposed under the IRO. In particular, the relevant person must comply with the requirements imposed upon employers under section 52 to give notice of the commencement (and cessation) of the individual's employment and other details (see ¶10-3100ff). Failure to do so is an offence under section 80 (see ¶13-0900).

Agreements to which section 9A applies

Section 9A applies in relation to any agreement under which remuneration for an individual's services is paid or credited, by a person carrying on a trade, profession, business, or prescribed activity, to:

- (a) a corporation controlled either by the individual himself or herself, by an associate or associates of the individual, or by the individual together with one or more associates;
- (b) a trustee of a trust estate under which the individual, or one or more of his or her associates, is a beneficiary; or
- (c) a corporation controlled by a trustee as described in (b) (section 9A(1)(a)–(c)).

The agreement needs not be in writing.

Section 9A also applies in relation to agreements which were entered into before 18 August 1995, but only in relation to services carried out and remuneration paid or credited on or after that date.

The scope of section 9A is extremely wide as the term “associate” is broadly defined to mean:

- a relative (i.e., a spouse, parent, child, brother or sister) of the individual;
- a partner of the individual, or a relative of that partner;
- a partnership in which the individual is a partner;
- any corporation controlled either by the individual, a partner of the individual, or a partnership in which the individual is a partner;
- any director or principal officer of such a corporation; or
- any other individual who is also a party to the service company or trust agreement (section 9A(8)).

If an agreement applies to two or more individuals, then section 9A(1) applies to them individually, not collectively (section 9A(7)(a)).

Prescribed activity

As yet, no activities have been prescribed for the purposes of section 9A. Therefore, the section currently applies only where the person who pays remuneration to a service company is carrying on or deemed to be carrying on a trade, profession or business. According to DIPN No 25 (Revised), this is expected to cover the vast majority of disguised employment arrangements. However, if it is discovered that other persons are entering into such arrangements, the Commissioner of Inland Revenue (“CIR”) has the power to prescribe specific activities, under section 9A(6), to bring them within the net of section 9A (DIPN No 25 (Revised), para 9).

¶2-0550 Section 9A “escape” provisions

To prevent legitimate non-employment arrangements from being deemed employee/employer relationships, section 9A sets out circumstances in which remuneration paid under such arrangements will not be deemed to be income from an employment. The conditions for exclusion from the operation of section 9A(1) are quite strict. It will be difficult for taxpayers to establish that service company or trust arrangements entered into by them are not simply disguised employer/employee relationships.

There are basically three circumstances in which an arrangement will “escape” the operation of section 9A(1):

- (i) where all of the key characteristics of an employment relationship are absent (section 9A(3));

- (ii) where the CIR is satisfied that no office or employment of profit exists (section 9A(4)); and
- (iii) where the person paying the remuneration and the individual performing the services are one and the same (section 9A(7)(b)).

Where specified characteristics of employment are absent

An individual performing services will not be deemed to be an employee of a person paying the remuneration for those services to a service company or trust if *all* of the following conditions are met:

- (a) Neither the agreement under which the remuneration is paid, nor any related undertaking, provides for the remuneration to include or provide for annual leave, passage allowances, sick leave, pension entitlements, medical payments or accommodation or similar benefits (section 9A(3)(a)). The question is not whether the relevant individual has received employment-type benefits but whether the agreement or related undertaking provides for such benefits (DIPN No 25 (Revised), para 22).
- (b) The individual personally carries out the same or similar services for persons other than any person for whom services are required to be carried out under the agreement (section 9A(3)(b)). This caters for genuine contractors who normally have more than one client (DIPN No 25 (Revised), para 23).
- (c) The performance of services by the individual is not subject to control or supervision, which would commonly be exercised by an employer, by any person other than the corporation or trustee concerned referred to in section 9A(1)(a), (b) or (c) (section 9A(3)(c)). Any control or supervision exercised by the service company may be disregarded. As a matter of practice, the Department also will not take into account supervision or control which can be attributed to statutory requirements and is not dependent on the existence of an employer/employee relationship (DIPN No 25 (Revised), para 25).
- (d) The remuneration is not paid or credited periodically or calculated on a basis commonly used under a contract of employment (section 9A(3)(d)). Regard must be had to the basis for calculating the payments. For contractor situations, payments are generally based on an agreed sum for specified work under a contract. Employment payments are usually in

respect of time worked, or position occupied, and made on a regular basis (DIPN No 25 (Revised), para 27).

- (e) The person paying the remuneration does not have the right to cause the individual to cease performing services in the way that an employer has the right to dismiss an employee under a contract of employment (section 9A(3)(e)). An employee's services can generally be terminated by providing notice or meeting other requirements under an award or statute. An independent contractor's contract is usually discharged by performance or it may specify default situations under which it can be terminated (DIPN No 25 (Revised), para 28).
- (f) The relevant person is not held out to the public as an officer or employee of the person paying the remuneration (section 9A(3)(f)). "Held out to the public" is not defined in the *Ordinance* and, therefore, must be given its ordinary meaning. Members of the public may be led to believe that an individual is an officer or employee of the relevant person, for example, through material included in trade or professional directories, journals or other publications, the issue of name cards, statements at public functions, information contained in press releases, etc. (DIPN No 25 (Revised), para 29).

Since all of the above conditions must be fulfilled in order for a service company or trust arrangement to escape the effect of section 9A(1), it is expected that section 9A(3) exemption will rarely apply. It is unlikely that even a taxpayer who genuinely is not an employee would be able to fulfil the stringent requirements of this provision.

The taxpayer in *Case M12* (2003) HKRC ¶80-877 (D108/01 IRBRD Vol 16)* was an actor who incorporated a service company for the purpose of contracting out the actor's services to a TV broadcasting company (the TV company) in Hong Kong. However, on application to the CIR in 1995 and in 1997, the CIR rejected the arrangement and took the view that the taxpayer was liable to salaries tax under section 9A(1) on the payments from the TV company. The taxpayer objected and appealed to the Board of Review. The taxpayer argued that section 9A(3) was satisfied as some paragraphs had been satisfied.

The Board of Review held that section 9A(1) shall not apply only where all the paragraphs in section 9A(3) are satisfied. In this case, that some paragraphs of section 9A(3) were satisfied did not assist the taxpayer. All the paragraphs must be satisfied in order for section 9A(1) not to apply. The taxpayer worked exclusively for the TV company and was bound to follow the directions of the TV company's production executives. His performance was controlled

or subject to controls commonly exercised by an employer over an employee. It was clear from the 1995 and 1997 service deeds that the TV company had contracted for the exclusive personal services of the taxpayer and that the interposition of the service company between the taxpayer and the service company was artificial. The onus of proving the assessment to be incorrect was on the taxpayer, and this onus had not been discharged.

See also *Case R6* (2008) HKRC ¶81-224 (D5/07), *Case Q28* (2007) HKRC ¶81-214 (D78/06 IRBRD Vol 22), *Case P19* (2006) HKRC ¶81-171 (D13/06 IRBRD Vol 21), and *Case N53* (2004) HKRC ¶81-029 (D62/03 IRBRD Vol 18).

In *Case H45* (1998) HKRC ¶80-553 (D103/97 IRBRD Vol 12), the consultancy agreement between the employer and the taxpayer's own company was found to be artificial and fictitious. The consultancy fees were held to be remuneration paid to the taxpayer. The arrangements were disregarded, and the taxpayer was assessed to salaries tax on the payments received by his own company.

Where the CIR is satisfied that no employment exists

An individual performing services will not be deemed to be an employee of a person paying the remuneration for those services to a service company or trust if the individual can establish, to the satisfaction of the CIR, that his or her performance of services was not, in substance, the holding of an office or employment of profit (section 9A(4)).

In exercising his discretion under this provision, the CIR will have regard to whether or not the individual's performance of services displays the accepted characteristics of an office or employment of profit as opposed to a contract for services, as set down in case law.

See ¶2-2850 for a discussion of the "control test", the "economic reality test" and the "integration test."

On the surface, this provision appears to provide a less stringent avenue for escaping the application of section 9A(1). However, careful consideration of all of the circumstances of the relevant arrangement will be required to determine whether or not an employment relationship exists. In practice, since the IRD has repeatedly expressed its intention to curtail the avoidance of tax through service company arrangements, the CIR is unlikely to exercise his discretion lightly. In order to escape the effect of section 9A(1) under this provision, an

individual may be required to establish many, if not all, of the factors required under section 9A(3) (listed above) in order to satisfy the CIR that he or she does not hold an office or employment of profit. Note, in this regard, the information required to be provided and the list of questions required to be answered by an individual who requests an advance ruling are set out under section 9A(4) (see below).

In *Case P19 (2006) HKRC ¶81-171 (D13/06 IRBRD Vol 21)*, the taxpayer sought to rely on section 9A(4) after failing to satisfy all the six criteria set down in section 9A(3). The Board noted the following facts of the case:

- (i) The taxpayer had only one full-time job at all material times, being a deputy director or consultant at the hospital. He had committed himself to work exclusively for the hospital for five years.
- (ii) The taxpayer received a steady monthly income from the hospital.
- (iii) The taxpayer was under the hospital's control and held himself out as its officer.
- (iv) The Board was unable to see any real entrepreneurship on the part of the taxpayer due to the absence of any business decision or managerial function to be made by the taxpayer and risk taken by the taxpayer.

By looking at the whole picture, the Board concluded that the relationship in question was one of employment in substance and section 9A(4) was not satisfied.

In *Case Y2 (2021) HKRC ¶81-540 (D3/20)*, the taxpayer and his wife were shareholders and directors of Company A which provided pre-floatation consultant services to Company B and its affiliated companies. Pursuant to section 9A, the Assessor considered that the management fees income of Company A from Company B was the taxpayer's employment income. Alternatively, the CIR took the view that the true relationship between the taxpayer and Company B was in substance one of employment and section 9A(4) was inapplicable and that the interposition of Company A between the taxpayer and Company B was a transaction caught by section 61, which was 'artificial or fictitious or is not in fact given effect to'.

The Board noted that on strict contractual terms, the services were to be rendered by Company A, not by any specific individual(s). Company B also claimed that it never occurred to them whether or not they were engaging the taxpayer's personal services as such,

and that their primary concern was simply whether they could have the benefit of the services which they needed at the time. In these circumstances, the Board found it is fair to say that whilst the parties expected that services to be rendered under the Agreements would be principally performed by the taxpayer personally, the Agreements were not for personal services. Thus, even though the taxpayer was expected to be principally responsible for performing the services under the Agreements, it would not be entirely apt to describe the relationship as one of employment in substance.

The Board therefore agreed that Company A and the taxpayer at the material time had genuine and practical entitlement to work for others and such finding was indicative of the existence of a relationship of independent contractor. The Board found that the carrying out of the consultant services by the taxpayer of Company A was not in substance an employment with Company B and they also did not consider that the interposition of Company A could be said as 'artificial' within the meaning of section 61. The Board agreed that the remunerations paid by Company B were not chargeable to Salaries Tax and the taxpayer's appeal is allowed.

Where the individual performing the services and the person paying the remuneration are the same

An employer/employee relationship cannot exist when there is only one party involved: a person cannot employ himself. Therefore, for the avoidance of doubt, it is specifically declared that section 9A(1) does not apply where either:

- (i) the person paying the remuneration is also the person performing the services; or
- (ii) the person paying the remuneration is a partnership and the person performing the services is a partner of the partnership (section 9A(7)(b)).

This excludes sole proprietors and professional firms with service companies from the operation of section 9A. The IRD's treatment of these service company arrangements is set out in DIPN No 24 (Revised): Profits Tax – Service Company "Type II" Arrangements (see ¶7-5740 and ¶14-4900).

Advance rulings

An indication of whether or not the CIR will exercise his discretion under section 9A(4) in favour of a taxpayer can be obtained through an advance ruling. Rulings will not be provided, however, in respect

of hypothetical, contemplated or proposed situations (DIPN No 25 (Revised), paras 47–49).

A request for an advance ruling must be in writing and signed by the relevant individual or his or her authorised representative. The following documentation should be provided in support:

- copies of the relevant agreement and any related undertaking (explanation and full details of terms and conditions must be provided if the agreement is not in writing);
- full details of remuneration payable under the agreement;
- copies of the organisation charts of the relevant person and the service company;
- a statement setting out the individual's:
 - duties and obligations in relation to the relevant person and the service company; and
 - previous employment history with the relevant person or any associated party;
- a statement listing the specified characteristics in section 9A(3) which have been satisfied; and
- an explanation why it is considered that the individual does not hold an office or employment of profit.

DIPN No 25 (Revised), Appendix B sets out the following series of questions relevant to the control, integration, economic reality and mutuality of obligation tests, answers to which should be provided in an application for an advance ruling.

Questions to be Answered when Applying for an Advance Ruling

- A. *Control Test* (to determine whether the relevant individual is controlled by the relevant person).
1. Who decides the work to be done by the relevant individual? Who prescribes the time schedule?
 2. Is there a fixed place of work? Who provides the place of work?
 3. Does the agreement (or related undertaking) between the service company and the relevant person require the relevant individual to perform the work personally?
 4. Is the relevant individual required to follow the rules and regulations of the relevant person?