

Tax

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Tax Analysis

Employer-employee relationship

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On 3 November 2017, the Court of First Instance (CFI) dismissed an appeal from the Commissioner of the Hong Kong Inland Revenue Department ("Commissioner") against the decision made by the Board of Review (BoR) (Case No. D11/16) regarding honorarium received by a taxpayer serving as workshop facilitator and examination marker (*Commissioner of Inland Revenue v Pang Fai HCIA2/2016*). To determine whether there is an employer-employee relationship, in addition to the commonly used tests, i.e. the control test and the economic reality test, the CFI judgement discussed the principles that should be used. This article explains the key tests and approach applied.

Background

The taxpayer, a certified public accountant, received honorarium from the Hong Kong Institute of Certified Public Accountants (HKICPA) for his services as a workshop facilitator and examination marker. The case at issue was whether an employer-employee relationship existed and whether the honorarium received from HKICPA should be charged to profits tax (under a contract for services) or salaries tax (under an employment).

Additional salaries tax assessment was issued by the Commissioner assessing honorarium as employment income. A BoR decision was made on 20 June 2016 which confirmed that an employer-employee relationship did not exist and the work was performed under a contract for services. As such, the honorarium received should be subject to profits tax. The Commissioner appealed against the BoR decision. Subsequently, CFI judgement was made on 3 November 2017, confirming the BoR decision and dismissing the Commissioner's appeal.

Commonly used tests

To determine whether an employer-employee relationship exists, one would commonly apply the following tests:

1. Control test – to determine whether the relevant individual is under control by the organization
2. Integration test – to determine whether the relevant individual is holding a position within the organization
3. Economic reality test – to determine whether the income of the relevant individual is in effect derived from the organization and whether the relevant individual is at risk with his capital

The BoR found that by only applying the control test and the economic reality test, one would agree with the Commissioner and found that an employer-employee relationship exists. For example, the HKICPA have control over the workshop materials, where and when the workshops were conducted, and time schedule on marking of the examination scripts. The taxpayer was required to follow the HKICPA's guidelines on the structure of the workshop and topics covered; he had to complete training sessions and briefing sessions; and he should mark the examination scripts in accordance with the marking scheme provided by the HKICPA. The taxpayer did not have to bear financial risks and he received a sum in return for his services performed for HKICPA.

Totality of facts approach

However, the BoR concluded that it was incorrect to adopt these tests here as then the unique features of this case would be ignored. The HKICPA is not running the relevant programs in order to make a financial return. The taxpayer in this case did not do the work for the purposes of gainful employment, rather the taxpayer is a professional man devoting his time and effort to the profession in return for an honorarium knowing that it is inadequate remuneration, but with the object of enabling the profession to maintain proper educational programs by which people who want to enter the profession can obtain the requisite qualification. The taxpayer also did not set out to make any profit as the reward is inadequate and inconsistent with an employer-employee relationship.

By stepping back and taking a holistic view, the BoR concluded that an employer-employee relationship did not exist and the taxpayer's work was under separate contract for services. Applying the same approach, the CFI confirmed the BoR decision and dismissed the Commissioner's appeal.

Conclusion

The BoR and the CFI have applied the totality of facts approach which has been the underlying guiding approach in many situations.

Whilst the common tests stated in the Departmental Interpretation and Practice Notes No. 25 (Revised) (i.e. the control test, the integration test and the economic reality test) are likely to be relevant in many cases, they are not the only and the most important indicia for determining whether a person stands in an employer-employee relationship. Whether those indicia are relevant, and the degree of their relevance, in any given case must depend on the circumstances of that case.

Hence, consistent with the Inland Revenue Department's underlying guiding approach, one should account for all facts and circumstances in each case to determine whether an employer-employee relationship exists.

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