

## **Bumpy tax landing for Cathay**

**Money-saving scheme at overseas bases backfires, meaning airline and some of its pilots could face tax demands in Hong Kong and abroad**

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Cathay Pacific and many of its overseas-based pilots are facing a financial hit after a perfectly legal "taxsaving" scheme set up in the early 1990s backfired.

One well-informed source said the problem may have already cost Hong Kong's flagship airline a substantial amount.

The revelation comes just days after Cathay reported a HK\$935 million first half loss, compared with a HK\$2.8 billion profit a year earlier.

In 1992, Cathay employed all its pilots overseas through a specially set-up shell company called Veta Limited.

The move was taken to save on foreign tax and social benefit contributions. But an aviation insider told the *Sunday Morning Post* that governments in several countries where Cathay has bases are seeking payment of outstanding contributions stretching back more than 20 years.

The Hong Kong Inland Revenue Department is also understood to be looking at possible outstanding payments linked to Cathay and many overseas-based pilots.

This means some pilots could be facing a double financial blow.

Sources familiar with the situation say the tax problem was the most significant reason for the airline's recent decision to close its Paris base and bring back dozens of pilots.

Cathay insisted it was because it was changing the type of planes it uses on European routes. But a veteran Hong Kong-based Cathay pilot, who requested anonymity, said he and his colleagues understood Paris would be just the first of several bases to close because of the tax issue.

The airline's network of overseas bases, which allows pilots to live in

their home countries, is unique in the business.

Cathay has bases in New Zealand, Australia, Canada, the US (Los Angeles and San Francisco), and Europe (Frankfurt, London and, until now, Paris). Most of the world's other airlines do not use expatriate pilots.

Cathay believed the Veta scheme would offer tax benefits. But in January 2006, Britain's House of Lords upheld an appeal court decision allowing George Crofts, one of 51 pilots sacked by Cathay in 2001, to seek compensation for what he saw as unfair dismissal by Veta.

The ruling set an important precedent as it denoted Crofts, an employee of a Hong Kong company, as being employed in the UK. This meant he was covered by UK employment legislation.

The source said: "Governments around the world started looking at these Cathay bases and worked out it was Cathay as their employer who was liable for the likes of their tax and social security. That's the real reason behind the closure of the Paris base.

"Being covered by employment legislation gave the pilots employment protection rights they didn't have in Hong Kong and exposed Cathay to the likes of social security payments."

Pilots who signed off with the tax office in Hong Kong to work from bases abroad in the belief that their tax commitments were dealt with may now face two demands for tax.

A Cathay spokesman said Veta was created to help establish bases for flight crew outside Hong Kong, but had very little impact on the company's tax position.

The airline confirmed the taxes being discussed with the Hong Kong tax office were personal taxes and that the issue arose when the office interpreted the tax code to include all Cathay crew based overseas.

"We appreciate this unexpected interpretation has caused some double personal taxation issues for some of our overseas staff and is an unwelcome development for those impacted," the spokesman said.

"Personal tax is a personal matter for the affected individual, but we are exploring what assistance we might be able to provide."

However, Cathay denied its decision to close the Paris base was to do with tax issues, saying it involved "operational factors".

Air Crew Officers Association general secretary Denis Dolan said: "It is inappropriate to make any comment at this time while discussions are still taking place."

A tax office spokesman said the department would not comment on an individual case.