

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D32/91

Profits tax – commission income – whether income arose in Hong Kong from the carrying on of business or trade in Hong Kong.

Panel: T J Gregory (chairman), Peter F Rhodes and E M I Packwood.

Dates of hearing: 7 and 8 February 1991.

Date of decision: 10 July 1991.

The taxpayer was a company carrying on business in Hong Kong as a commission agent handling textile articles manufactured in the People's Republic of China. The taxpayer assisted manufacturers in China to sell their products overseas and overseas customers to purchase goods manufactured in China. The taxpayer received a commission payable part by the overseas customer and part by the manufactures in China. The taxpayer despatched employees to China to find articles which it thought would be suitable for its overseas customers and assisted overseas customers in negotiating with manufacturers in China. The taxpayer argued that the commissions earned by it were earned in respect of its activities in China and accordingly did not arise in and were not derived from Hong Kong.

Held:

It was necessary for the Board to decide what the taxpayer did to earn the commission income, when the commission income was earned, and where the taxpayer did what was required of it to earn the commission income. On the facts before it, the Board held that the taxpayer earned the commission income by securing buyers for the manufacturers' products and by securing manufacturers to fabricate the specific products required by its customers. The taxpayer earned its commission income when the contractual obligation arose between the buyers and the manufacturers. On the evidence before the Board the material aspects of what the taxpayer did to earn the commissions were all undertaken by the taxpayer in Hong Kong.

Appeal dismissed.

Cases referred to:

CIR v Hang Seng Bank Limited (PC) [1990] 2 WLR 1120  
Smidth & Co Limited v Greenwood [1921] 3 KB 583  
CIR v Lever Brothers [1946] SATC 1  
Commissioner of Taxation v Kirk [1900] AC 588

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Lovell and Christmas Limited v Commissioner of Taxes NZ [1908] AC 46  
Rhodesia Metals Limited v Commissioner of Taxes (SA) [1940] AC 774  
Tariff Reinsurance Limited v Commissioner of Taxes (Victoria) 4 ATD 498  
CIR v The Hong Kong and Whampoa Dock Co Limited [1960] 1 HKTC 85  
Federal Commissioner of Taxation v United Aircraft Corporation 7 ATD 318  
Federal Commissioner of Taxation v Mitchum 13 ATD 497  
Esquire Nominees Limited v Federal Commissioner of Taxation 72 ATC 4007 –  
On appeal 73 ATC 4115  
Federal Commissioner of Taxation v Efstathakis 79 ATC 4257  
Hillsdon Watts Limited v Commissioner of Taxation ATD 199  
Bank of India v CIR 2 HKTC 503  
Exxon Chemical International Supply S A v CIR 3 HKTC 57  
CIR v International Wood Products Limited [1971] 1 HKTC 551

E C D'Souza for the Commissioner of Inland Revenue.  
Jillian Saint of KPMG Peat Marwick for the taxpayer.

### Decision:

#### 1. THE SUBJECT MATTER OF THE APPEAL

The Taxpayer appealed against the determination of the Commissioner which uphold additional profits tax assessments raised on it for the years of assessment 1983/84 and 1984/85 and profits tax assessments raised on it for the years 1985/86, 1986/87 and 1987/88. The Taxpayer maintained that certain of its income did not arise in Hong Kong from the carrying on of business or trade in Hong Kong.

#### 2. THE FACTS

The facts, which were not in dispute, may be summarised as follows:

- 2.1 The Taxpayer was incorporated as a private company in 1976. The Taxpayer was carrying on business in Hong Kong during the period 1 January 1983 to 31 March 1988 ('the relevant period').
- 2.2 Throughout the relevant period the Taxpayer's business, as reported to the Revenue, was 'import/export of textiles, commission agents'.
- 2.3 In each of its profits tax returns for the years of assessment 1983/84 to 1986/87 the Taxpayer excluded, in the accompanying tax computations, the amount which represented the net commissions and related exchange gain (that is after deducting the attributable operating expenses) ('the commission income') which it maintained had arisen outside of Hong Kong. The amounts in question are as follows:

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<u>Year ended</u>	<u>31-3-84</u> \$	<u>31-3-85</u> \$	<u>31-3-86</u> \$	<u>31-3-87</u> \$
Commission income (overseas)	1,312,599	1,458,596	1,659,940	1,309,965
Exchange gain on overseas commission	-	-	18,539	15,659
	<u>\$1,312,599</u>	<u>\$1,458,596</u>	<u>\$1,678,479</u>	<u>\$1,325,624</u>
<u>Less:</u>				
Expenses relating to overseas commission	479,070	413,264	589,841	759,182
Agency commission relating to overseas commission	-	-	105,743	256,391
Net amount claimed as not assessable	<u>\$833,529</u>	<u>\$1,045,332</u>	<u>\$982,895</u>	<u>\$310,051</u>

2.4 The assessor did not accept that the commission income arose outside of Hong Kong and issued profits tax assessments and additional assessments as follows:

2.4.1 Additional assessment in respect of the year of assessment 1983/84 (issued on 17 March 1988):

	\$
Profit as previously notified	1,111,466
<u>Add:</u> Commission received for services rendered overseas	<u>1,312,599</u> \$2,424,065
<u>Less:</u> Proportion of operating expenses relating to earning of commission	<u>479,070</u> 1,944,995
<u>Less:</u> Profit as already assessed	<u>1,111,466</u>

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Additional assessable profits		<u>\$833,529</u>
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Tax payable thereon		<u>\$137,532</u>
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2.4.2 Additional assessment in respect of the year of assessment 1984/85 (issued on 17 September 1988):

	\$		\$
Profit as previously notified			2,303,921

<u>Add:</u> Interest income		126,781	
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Commission received for services rendered overseas		<u>1,458,596</u>	<u>1,585,377</u>
			\$3,889,298

<u>Less:</u> Proportion of operating expenses relating to overseas commission income			<u>413,264</u>
			\$3,476,034

<u>Less:</u> Profit as already assessed			<u>2,303,921</u>
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Additional assessable profits		<u>\$1,172,113</u>
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Tax payable thereon		<u>\$216,840</u>
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2.4.3 Year of assessment 1985/86 (issued on 5 July 1989):

	\$		\$
Profit per return			631,025

<u>Add:</u> Interest income		302,618	
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Commission income overseas		1,659,940	
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Exchange gain on overseas commission		<u>18,539</u>	<u>1,981,097</u>
			\$2,612,122

<u>Less:</u> Proportion of operating expenses relating to			
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	overseas commission	589,841	
	Agency commission relating to overseas commission	105,743	
	Depreciation allowance further allowed	<u>852</u>	<u>696,436</u>
	Assessable profits		<u>\$1,915,686</u>
	Tax payable thereon		<u>\$354,401</u>
2.4.4	Year of assessment 1986/87 (issued on 20 January 1989):		
		\$	\$
	Profit per return		756,164
	<u>Add:</u> Overseas commission	1,309,965	
	Exchange gain from overseas commission income	<u>15,659</u>	<u>1,325,624</u> \$2,081,788
	<u>Less:</u> Agency commission relating to commission income	256,391	
	Proportion of operating expenses relating to overseas commission	759,182	
	Depreciation allowance further allowed	<u>375</u>	<u>1,015,948</u>
	Assessable profits		<u>\$1,065,840</u>
	Tax payable thereon		<u>\$197,180</u>

2.5 Through letters addressed to the Revenue by its tax representatives, the Taxpayer objected to these assessments and additional assessments on the ground that the commission income related to services rendered overseas whereby the commission income together with the related exchange gain, after deducting the attributable operating expenses, was not subject to Hong Kong profits tax.

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- 2.6 The Taxpayer failed to submit a profits tax return for the year of assessment 1987/88 within the time stipulated on the return. Accordingly on 20 January 1989, pursuant to section 59(3) of the Inland Revenue Ordinance ('the Ordinance'), the assessor raised the following profits tax assessment on the Taxpayer:

Estimated assessable profits \$1,500,000

Tax payable thereon \$270,000

- 2.7 The Taxpayer submitted its profits tax return for the year of assessment 1987/88 on 23 January 1989. The 'net' overseas commission and related exchange gain (after deducting the attributable operating expenses) in the amount of \$226,344 was excluded from the assessable profits in the tax computation. Thereafter, by letter dated 14 February 1989, inter alia, the Taxpayer's tax representatives lodged an objection against the assessment in the following terms:

'The grounds for our objection are:

1. That the estimate is excessive and incorrect.
2. That the assessable profits as stated in the estimated assessment should be reduced to \$1,284,844 in accordance with the profits tax computation for the year of assessment 1987/88 already lodged.'

- 2.8 In his determination issued on 3 September 1990 ('the determination'), the Commissioner:

2.8.1 upheld the additional profits tax assessments for the years of assessment 1983/84 and 1984/85;

2.8.2 confirmed the profits tax assessments for the years of assessment 1985/86 and 1986/87; and

2.8.3 increased the profits tax assessment for the year of assessment 1987/88, which had been based on estimated assessable profits, with benefit of the return ultimately submitted by the Taxpayer, to assessable profits of \$1,511,188 with tax payable thereon of \$272,013.

- 2.9 By letter dated 28 September 1990 the tax representatives gave notice of appeal on behalf of the Taxpayer. The ground of appeal was that profits tax was not payable on the amounts in dispute namely:

<u>Year ended</u>	<u>31-3-84</u>	<u>31-3-85</u>	<u>31-3-86</u>	<u>31-3-87</u>	<u>31-3-88</u>
Net amount					

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claimed as not  
assessable                      \$833,529    \$1,045,332    \$982,895    \$310,051    \$226,344

on the basis that the income arose from sources outside Hong Kong, and did not fall within the scope of section 14 or any other provision of the Ordinance under which those profits are chargeable to profits tax.

### 3. THE CASE FOR THE TAXPAYER

#### 3.1 Opening Submission

In an opening submission the Taxpayer's representative:

- 3.1.1 advised the Board that the point in issue was whether the profits derived from the commission income had a source outside Hong Kong whereby they should be excluded from the Taxpayer's assessable profits for the years of assessment in question;
- 3.1.2 gave background information as to the Taxpayer, which is reflected in section 2 above;
- 3.1.3 drew the attention of the Board on the Taxpayer's audited accounts;
- 3.1.4 addressed the overall requirements of section 14 of the Ordinance and acknowledged that the Taxpayer carried on a trade, profession or business in Hong Kong and that the commission income was earned from that trade, profession or business whereby the only issue was whether the profits arose in or were derived from Hong Kong;
- 3.1.5 outlined for the Board the approach to be adopted to determine the source of profits;
- 3.1.6 outlined the evidence of two of the three witnesses who were called; and
- 3.1.7 briefly anticipated the submission that would be made in support of the Taxpayer's appeal.

#### 3.2 The Evidence

##### 3.2.1 First Witness

- 3.2.1.1 Throughout the relevant period the witness was the manager of the Taxpayer's [X division], a position he had held throughout his twenty-five years of employment by the Taxpayer. In his evidence he explained that:

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- 3.2.1.1.1 The Taxpayer had three divisions, one of which being the division of which he was manager and that there were five suppliers of products, all of whom were named, from whom the Taxpayer received commissions.
- 3.2.1.1.2 The commissions received fell into two categories, a percentage from the suppliers he had previously named who were usually located in the PRC and the same percentage from its customers, who were located, principally, in Europe, particularly the United Kingdom.
- 3.2.1.1.3 Commissions from two of the suppliers he had previously named were booked to his division. Commissions from two of the others, which to his knowledge were earned on the same basis as those earned by his division, were booked to the Taxpayer's [Y division] and commissions from the remaining supplier, which, again, to his knowledge were earned on the same basis as those earned by his division, were booked to the [Product Z division] in the Taxpayer.
- 3.2.1.1.4 The Taxpayer's European customers with whom the witness dealt do not maintain buying divisions in this region. Accordingly, the Taxpayer provided a service which he explained comprised the identification of product lines of interest to them, the negotiation of purchase details, including quantities, prices and delivery schedules, undertaking quality control inspection and overseeing shipment schedules.
- 3.2.1.1.5 As a rule the Taxpayer did not execute formal agreements with either payer of the commissions. It relied on the working relationships developed over the years.
- 3.2.1.1.6 The method by which the Taxpayer earned the commissions was:
- 3.2.1.1.6.1 For the Taxpayer to be appointed by a customer to arrange for the manufacture of a product required by the buyer. This appointment would be by letter or fax. The Board was referred to a telex in early 1987 transmitted to the witness by customer A and a letter addressed to him by the same customer dated 30 July 1987 to illustrate this aspect of his evidence. He added that manufacturers in the People's Republic of China ('PRC') had difficulties with colour and the Taxpayer had to assist in obtaining the correct colour.
- 3.2.1.1.6.2 Because of the long association between the Taxpayer and many of its customers the Taxpayer understood that any such enquiry which was answered satisfactorily would, in due course, involve the Taxpayer in the additional services he had already outlined, refer paragraph 3.2.1.1.4 above, particularly quality control and shipment monitoring, and that any failure on its part in those respects would almost certainly lead to a dispute as to the payment of the commission by the customer.

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- 3.2.1.1.7 Because of the long association between the Taxpayer and many of its customers the Taxpayer sometimes received very general enquiries including making available all types of garments which a particular customer would normally order, with emphasis on new styles.
- 3.2.1.1.8 The Taxpayer also received specific instructions. The Board was referred to another letter from customer A dated 24 August 1987 with respect to an enclosed sample of product A. This letter also referred to other products, a photocopy of each being annexed. This letter was typical of this type of enquiry.
- 3.2.1.1.9 The instructions he received included requests for information as to:
- 3.2.1.1.9.1 new products to be made to the customers' instructions;
- 3.2.1.1.9.2 new ideas from the PRC as to products; and
- 3.2.1.1.9.3 colour ranges available from the PRC.
- 3.1.1.1.10 Once those instructions were received they would be transposed onto a 'samples order'. The Board was referred to a typical example dated 7 March 1989, which contained an illustration of product B together with manuscript instructions as to detail in Chinese characters to enable the addressee to understand the Taxpayer's customer's requirements. A larger version of the illustration headed 'Spring, Summer 1990' also with information in Chinese characters is annexed to this document. He, personally, would take this 'samples order' to the PRC for manufacture and price quotation. The Board was referred to a copy telex sent by him to another customer, customer B, as an illustration of this type of excursion and what the witness did when he was in the PRC. In his experience it normally took six to seven days for a sample to be produced.
- 3.2.1.1.11 When a manufacturer advised that samples were ready the witness would go to inspect them. The Board was referred to a copy fax dated 10 March 1987, which he had addressed to customer A as an illustration of this type of excursion and what the witness did when he was in the PRC. He added that face to face meetings with manufacturers were necessary as they do not read or understand English and he had to interpret the customers' requirements in minute detail. Frequently, samples were made incorrectly and he had to go to make sure they were made correctly. Correctly made samples would be hand-carried by him to Hong Kong and then sent to the customers.
- 3.2.1.1.12 The Taxpayer allocated its own reference number to a sample to discourage its customers from dealing directly with the manufacturers. This was illustrated by a copy telex dated 8 May 1987 from customer A.

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- 3.2.1.1.13 PRC manufacturers need very close supervision during all stages of manufacture as they have very poor administrative systems. For example, a sample might be returned to be altered but the altered sample may be given the same reference number as the original whereby the manufacturer would not know which sample was referred to in an order. It was one of the witness' duties to ensure that requested alterations had been undertaken. An example of an occasion when there had been the incorrect fabrication of a sample was illustrated by a fax in mid-1987 which was addressed to customer A.
- 3.2.1.1.14 Once a sample was ready to be sent to a customer, application was made for an export licence. Thereafter, the customer was invoiced for the sample. PRC manufacturers charged for samples and the Taxpayer passed the cost onto its customers. The Board was referred to an example of such an invoice to customer A. In due course the customers would pay the Taxpayer's invoices. The Board was referred to an example namely customer A's payment advice.
- 3.2.1.1.15 The Taxpayer's bigger customers, who had received samples and market-tested them, would normally come to Hong Kong once or twice a year to visit the PRC with, usually, all travel arrangements and meetings having been scheduled by the Taxpayer. The witness would accompany these visitors to their meetings with the manufacturers when they negotiated colour selection, size ranges, prices and delivery schedules.
- 3.2.1.1.16 After such visit the manufacturers will make additional samples, to represent the ranges selected by the customers. The Taxpayer would be notified when these samples were ready and the witness would go to the factory to inspect. Required alterations, if any, would be ordered by him. Satisfactory samples were hand-carried by the witness to Hong Kong to be sent to the customers for marketing.
- 3.2.1.1.17 Once the customers were happy with the samples they request the Taxpayer to place an order on the customers' behalf. The Board was referred to an order from customer A dated 6 April 1987. On receipt of such orders the Taxpayer transposed the customers' order onto its own order forms. The Board was referred to an example dated 8 April 1987 which the witness said disclosed that the Taxpayer acted as a commission agent only. Thereafter, the orders were sent or delivered to the manufacturers which issued 'sales confirmations'. The Board was referred to an example dated 20 April 1987. This document identifies the buyer as the Taxpayer's customer, in this example customer A, and the Taxpayer as an intermediary. The witness said that this document was always prepared and signed in the PRC (although the Board notes that this example was not signed), and collected by the witness in the PRC after he was satisfied that it correctly reflected the order. Thereafter, the Taxpayer retyped the detail on its own invoice which was forwarded to the customer for acceptance, evidenced by the return of a signed copy (which the Board notes is unsigned by either the Taxpayer or its customer). The only difference between

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the manufacturer's sales confirmation and the document prepared by the Taxpayer was the reference numbers which were different for the reasons already referred to by the witness in paragraph 3.2.1.1.13 above.

- 3.2.1.1.18 The Taxpayer had no authority to accept any price or other changes requested by the manufacturers without the customers' specific approval.
- 3.2.1.1.19 During manufacture the witness would go to the PRC to undertake quantity checking, check changes to manufacturing requirements and perform quality control tests. The Board was referred to several copy documents dealing with these matters.
- 3.2.1.1.20 Goods were transhipped in Hong Kong as this was necessary, first, for consolidation of shipments and, secondly, to avoid transshipment in Hamburg where the PRC vessels docked as they operated no direct services to any United Kingdom port.
- 3.2.1.1.21 The witness produced a schedule of his visits to the PRC between 1 April and the next following. 31 March in the years 1983/84, when he made ten trips lasting sixty-five days or forty-seven days excluding one day going and one day returning, 1984/85, when he made twelve trips lasting sixty-two days or fifty days excluding travelling days, 1985/86, when he made nine trips lasting forty-nine days or thirty-nine days excluding travelling days, 1986/87, when he made fifteen trips lasting fifty-nine days or forty-four days excluding travelling days, and 1987/88, when he made twenty trips lasting ninety-two days or seventy-two days less travelling days.
- 3.2.1.1.22 Occasionally, there were quality problems with merchandises shipped and the witness would endeavour to negotiate a settlement between the manufacturers and the Taxpayer's customers. The Board was referred to two fax messages from the Taxpayer to two of its customers, each conveying an offer by a manufacturer to compromise a dispute.
- 3.2.1.1.23 There could also be problems associated with shipment which the witness would endeavour to resolve.
- 3.2.1.1.24 Commissions due to the Taxpayer were paid by bank draft by both the manufacturers and the customers.
- 3.2.1.2 Cross-examination
- 3.2.1.2.1 Having confirmed that he was familiar with the determination, the witness confirmed that he was the principal person involved in the production of commission income and that he administrated the staff allocated to [X division].

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- 3.2.1.2.2 He confirmed that between 1983 and 1985 he did not identify one new customer or supplier.
- 3.2.1.2.3 He confirmed that latterly small amounts of commission had been received from the manufacturer in Place X, China and that prior to that it had been Place Y, China.
- 3.2.1.2.4 The witness stated he had personal knowledge of all types of commissions earned by the Taxpayer although some of them were earned by another divisions. He named the product ('product C') with respect to which the commission in the other division was earned. When asked if they required the same quality of inspection as [products of X division] the witness replied that that product was not his line of product. When challenged that he had claimed personal knowledge of all types of commissions earned his reply was that that was company policy. He did not answer whether quality control was not rendered for product C. When asked about the nature of products from another manufacturer the witness stated that they were not his line.
- 3.2.1.2.5 When questioned about an European manufacturer the witness again stated that it was not his area of responsibility or his line. A similar response was given to questions about product Z as mentioned in paragraph 3.2.1.1.3 above.
- 3.2.1.2.6 He was referred to a sales agency agreement. The witness recognised the document. He stated that it was a sales agency agreement for [a product of X division] for a Canadian company. The witness was referred to an agreement between an associated company of the Taxpayer and a Chinese manufacturer for sales to Canada or USA (which sets out an explanation afforded by the Taxpayer's tax representatives, namely the basis under which the Taxpayer undertook business). It was pointed out to him that no such obligation was set out in the sales agency agreement and was asked what the agent named in that agreement would do to earn commission. The witness' reply was that that agent would find customers but he was not involved with Canada. He was involved with Hong Kong alone.
- 3.2.1.2.7 The witness was then referred to a document which was an order from a customer in England. He stated that the article number was that of the Taxpayer and confirmed that the price was in RMB. The witness stated that the customer knew the Taxpayer's order number as a sample has previously been provided. The customer's request for three pieces was not from items that the Taxpayer had in stock. They were obtained from the PRC and that he had collected them personally.
- 3.2.1.2.8 The witness was asked whether he maintained notes or diaries of his discussions with manufacturers. He replied in the affirmative and agreed that copies were not amongst the documents which the Taxpayer had produced for the appeal.

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- 3.2.1.2.9 He confirmed that the Taxpayer communicated with manufacturers in the PRC by telex. However, he did not understand the question as to why none had been produced for inspection by the Board.
- 3.2.1.2.10 With respect to the order referred to in paragraph 3.2.1.2.7 above, the witness agreed that that order originated a transaction. The said order amounted to some RMB50,000 which would involve RMB2,500 commission from each the supplier and the customer. He transposed the order from England onto an order confirmation to be addressed by the Taxpayer to the manufacturer. He agreed that the reference number would be different. The manufacturer sent a sales confirmation which, in turn, was transposed onto the Taxpayer's order form but with a different reference number. This was to avoid customers being able to communicate directly with the manufacturers. The witness was unable to understand why it was necessary to keep the manufacturers and the customers apart if the Taxpayer was remunerated for the services it rendered for the customers in the PRC.
- 3.2.1.2.11 The witness was then questioned with respect to products C, D and E which were supplied by a manufacturer and whether or not they were inspected. The witness stated the goods were inspected but that it was not his area so he could not explain. The witness was reminded of his evidence as to the necessity for goods to be shipped via Hong Kong and why for that particular order the goods were shipped directly. His answer was that they would be shipped directly if the customer did not insist on transshipment. The witness stated that goods were not inspected in Hong Kong as they arrived packed.
- 3.2.1.2.12 The witness stated that three to four customers sent representatives to Hong Kong once or twice a year. Most preferred to come only once but it would depend on the volume of business. He confirmed that he accompanied these visitors in the PRC and that, on average, these visits lasted about a week. The witness declined to agree that these visits would only take up about twenty-eight days of his time in a year.
- 3.2.1.2.13 The witness was referred to the schedule of his visits to China. He was asked that if twenty-eight days were deducted from his visits in 1983 or 1984 how much time was left for him to perform all his other duties. The witness' answer was that May was the beginning of the season. August and September would be the time of year when product A would be inspected for delivery in the following year. Samples would be received in June and July, and, in August and September inspections would take place. The following February and April would be devoted to the following winter season.
- 3.2.1.2.14 He stated that he would not be on a visit to China with more than one customer at a time.

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- 3.2.1.2.15 The witness was then referred to a product referred to in customer A's telex in early 1987. He stated that the product was a 'hot item' in the United Kingdom and having received the telex he had to go to the PRC for a sample. He confirmed that the item was not in any catalogue but the customer knew him and relied on him to go to the PRC and find the product.
- 3.2.1.2.16 He was then referred to a letter from customer A in mid-1987 which referred to repeat orders. When asked that there would be nothing for him to do on repeat orders, the witness stated that even for repeat orders there would be work to do including questions associated with changes of colour. When referred again to the same passage in the same document which referred to an exact repeat and asked what service he provided, he stated that he had to go for new samples as materials and/or the quality of materials changed all the time.
- 3.2.1.2.17 The witness confirmed that he went to the PRC to collect samples for customers other than customer A. The witness was then referred to a copy of a telex from the Taxpayer to another customer, customer B.

He was asked why he referred to 'our samples' in his telex to customer B. The witness replied that this referred to the samples already sent to customer B. When asked about a further passage in the same telex reading:

'WE SHALL SHIP FIRST LOT ... W/I 24 HOURS'

which implied that the Taxpayer would ship, as opposed to tranship. The witness stated that there were two types of factory, namely joint ventures in South China, which were very close and for whom the Taxpayer arranged shipment.

- 3.2.1.2.18 The witness confirmed that every time he collected a sample, it was sent to the customer from Hong Kong and stated that it was not possible to send samples from the PRC. He confirmed that he always hand-carried samples to and from the PRC.
- 3.2.1.2.19 The witness was then referred to a fax addressed to customer A which referred to an incorrectly made sample not having been sent as it had been incorrectly made. He was asked how this could happen to which his reply was 'Good question. They make mistakes'. But he then asked how it could happen if he himself hand-carried samples, his reply was that if the 'mistake' was not big he would bring them. He was then referred to his fax to customer A and a passage reading:

'SAMPLES SENT ... WERE INCORRECTLY MADE.'

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He was asked why they had been sent. His answer was that this was by agreement with customer A. Customer A wanted the samples even if they were wrong.

- 3.2.1.2.20 The witness gave no relevant answer to a question asking if he had anything relating to what he did in the PRC to prove that he was there.
- 3.2.1.2.21 The witness was asked what he could do in the PRC if he only spent forty days there in a year with so much travelling time involved. The witness' reply was that that was one of the reasons he travelled frequently to the PRC.
- 3.2.1.2.22 The witness was then referred to a fax to customer A. His attention was drawn to the fact that this was a reply to a fax from customer A and that the topic was orders and counter-offers. It was pointed out that there were no documents setting out any quotations from the manufacturers in the PRC. The witness replied that he got quotations when he went to the factory. When told that there were no papers to support that answer he said that he made rough paper notes which were thrown away. Having had it drawn to his attention that the transaction referred to in this document was done by fax he confirmed that acceptance by the manufacturer was by telephone.
- 3.2.1.2.23 The witness was then referred to the order from customer A and asked why the customer insisted on transshipment in Hong Kong. The witness replied that this was to achieve cost savings by consolidating cargo locally.
- 3.2.1.2.24 The witness was then referred to the telex from customer A which, it was suggested, disproved that customer A always had goods transhipped. The witness stated that if shipment was direct from the PRC it would be cheaper and that the customer preferred direct shipment.
- 3.2.1.2.25 The witness was then referred to the Taxpayer's order form (refers to paragraph 3.2.1.1.17 above). He was asked what the words '[Product A] SIZE: As per your original sample' meant. The witness replied that the document went to the manufacturer and that the reference was to the size of product A.
- 3.2.1.2.26 The witness was then referred to the manufacturer's sales confirmation (refers to paragraph 3.2.1.1.17 above), and that this identified customer A as the buyer and the Taxpayer as intermediary and required transshipment in Hong Kong. The witness was referred to printed condition no 5 on the sales confirmation requiring one copy be signed and returned within ten days of receipt. He was asked whether, if nothing happened thereafter, the Taxpayer had earned the commission. The witness replied in the negative and referred to the strong relationship between the Taxpayer and that particular manufacturer. The question was repeated and his answer was that the Taxpayer signed the sales confirmation. He added that the manufacturer considered the Taxpayer to be the buyer.

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- 3.2.1.2.27 The witness was then referred to a fax to customer A dated 7 August 1987. He agreed that the first subject addressed in the fax referred to the quality of [a product of X division]. When asked if there was any evidence that the information from the PRC which he referred to was not communicated on the telephone or telex, the witness stated that this was apparent from the sample he had carried out from the PRC and that he had pointed this out to customer A before it was mailed to customer A. He was referred to the second item addressed related to problems with fabrics. He was asked if he remembered, whether this information was given to him whilst he was in the PRC as opposed to it being advised by telex or by telephone. His reply was that it was apparent from the sample he carried out. When asked whether there was any evidence to support his explanations he stated that he had discussed the matter face to face in the PRC.
- 3.2.1.2.28 The witness was then referred to a fax to customer A which dealt with 'spring samples'. The passage was read and the witness was asked whether earlier samples had been carried out on his behalf. His answer was in the negative and he repeated that he always personally carried out the samples.
- 3.2.1.2.29 The witness was then referred to paragraph 7 in the fax from customer A dated 2 June 1987 reading:
- ‘ THE SHAPE OF THIS SMPL IS DREADFUL AND ANYWAY SHLD BE SIZE [a number cited] MAX ... ’
- The witness was asked whether, if he had inspected the sample named in the passage, he would not have sent it out. He said that the sample was sent for colour as opposed to shape.
- 3.2.1.2.30 He was then asked whether the periods he had spent outside Hong Kong were correctly recorded. It was understood that his 'visa book' had been lost and the witness was asked if he had reported the loss. His answer was that his 'visa book' had expired. It was pointed out to the witness that the schedule gave no reason for his visits to which he answered that the 'visa book' would show that. It was also pointed out that the schedule did not show the reasons for those visits to which the answer was 'business'.
- 3.2.1.2.31 The witness was then referred to the schedule of his trips to the PRC. It was pointed out that this schedule discloses that he was in the PRC between 7 and 10 March 1988. He was then referred to the fax to customer B dated 4 March 1988, in which it is stated that the witness was 'now in Southern China'. The witness replied that a visa was not required for a visit to Shum Chun. He was then asked whether a number of his visits to the PRC were not factory visits but visits to trade fairs. He replied that all manufacturers were at trade fairs. The witness agreed that he was not inspecting merchandise when at a trade fair and

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his reason for going to the Canton Trade Fair was to locate new suppliers. When asked what profit the Taxpayer made from locating a new supplier the witness gave an irrelevant answer. When the question was repeated he stated that no profit was made from locating a supplier; the profit was made after a relationship had been built up and an order finalised. When asked when an order was finalised his answer was when it was confirmed. When asked when the profit was made the witness replied 'that this was when the order was obtained'.

- 3.2.1.2.32 The witness was reminded that there was no documentation which established what he had done when he was in the PRC. He answered that the important thing was to work face to face with the manufacturers and that it was not normal for there to be anything in writing. When asked what happened when he had several orders from different customers he stated that he only advised the manufacturers as to quantities and colours.
- 3.2.1.2.33 He was referred to his fax to customer A dated 22 June 1987 and to a paragraph dealing with compensation. He was asked whether there was anything in writing or whether it was all done face to face. The witness replied that he would negotiate the details personally, make notes and then discard his notes after what had been discussed had been faxed to his customer. He was asked why he retained the fax and not the documents from which the fax was prepared. His answer was he had thrown them away. He confirmed that he did not append his copy of his notes to the file copy of his fax to confirm what he had agreed in the PRC. The fact that the date of this particular fax had been changed from July (typed) to June (manuscript) was because there had been a typographical error.
- 3.2.1.2.34 The witness was unable to state whether the Taxpayer carried on an import/export trade and paid tax on its profits from that business but the Taxpayer's tax representative agreed that this was the case.
- 3.2.1.2.35 The witness stated that the Taxpayer had no manufacturers based in Hong Kong from whom commission income arose. The witness also confirmed that no commission income was received from product A manufactured in Hong Kong.
- 3.2.1.2.36 The witness was referred to the fax to customer B dated 4 March 1988, and asked why the items referred to were quoted in Hong Kong dollars. He stated that this was a requirement of the manufacturer. The manufacturer was owned by Hong Kong people and, as he put it, they were 'modern'. The witness was reminded that his evidence was that he personally brought every sample from the PRC to Hong Kong, which he acknowledged. He was asked whether the delay in the delivery of the samples referred to in paragraph 4 of that fax had occurred in the PRC. The witness replied that the delay occurred in Hong Kong.

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- 3.2.1.2.37 The witness was then referred to customer A's telex dated 3 March 1987 and the second paragraph commencing 'What has happened?'. Customer A was complaining about problems which had arisen. He was asked to explain and asked whether he was unable to get to the PRC or whether there were delays in obtaining a telephone connection. He replied by stating that the explanation for the complaint in the first paragraph of this telex was because the manufacturer had not followed instructions. He was asked again what was meant by the phrase 'communication difficult' to which his reply was that telephoning was always difficult and it was necessary to solve problems face to face.
- 3.2.1.2.38 He was then referred to his fax to customer A dated 5 March 1987. The first two sentences refer to problems with shipping marks and a conversation he had had with a manager of the manufacturer who, as was asserted, confirmed that the witness had had telex and/or telephone contact with the PRC but that nothing had been exhibited with respect to that conversation. The witness replied he would have made a note of his conversation and had it typed up by a secretary.
- 3.2.1.2.39 He was asked why he kept copies of documents sent to London but not what he sent to the PRC. The witness replied that he had made five copies of everything and kept one and the others were circulated.
- 3.2.1.2.40 The witness was then referred to a telex and a debit note to the European manufacturer referred in paragraph 3.2.1.2.5 above dated 23 January 1984 and asked why copies of telexes to that European manufacturer were retained but not all to the PRC. The witness stated that that manufacturer was not his account and that he knew nothing about that particular matter.
- 3.2.1.3 Re-examination:
- 3.2.1.3.1 The witness was referred to copies of telexes from Place Y, China and asked when telexes would be sent to the Taxpayer. The witness stated the telexes would include those confirming letters of credit which had been opened, and that the Taxpayer was telexed because they were the agent, and that as agent it needed to know to enable it to follow up.
- 3.2.1.3.2 He was asked if he telephoned the PRC on a daily basis to which his answer was that sometimes a day was wasted trying to get through and that was why he preferred to go to the PRC and also deal with the manufacturers face to face.
- 3.2.1.3.3 He stated that his visits to South China were infrequent as most of the manufacturers were located in Place Y, China. He confirmed those visits were not on the schedule of his trips to the PRC.

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3.2.1.3.4 He confirmed that between 1983 and 1988 the Taxpayer had obtained only one new customer. He said, by way of explanation, that customer disliked visiting the PRC. Whilst the Taxpayer would have liked extra customers, one of its customers held one third of one relevant quota. Accordingly, he spent more time serving the existing customers rather than seeking new ones.

3.2.1.3.5 He was referred to the sales confirmation of 20 April 1987, and then asked if an order had ever been cancelled. He replied in the negative and added that a manufacturer would never cancel and the Taxpayer's customers did not.

3.2.1.4 Questions from the Board:

Having been referred by the Board to the 'samples order' and his evidence that he had prepared this, he was asked if he had drawn product B on the order himself or whether he had received a drawing to which he had added the Chinese characters. He replied that the product had been drawn by himself, not an artist, and that he had done this in Hong Kong. When asked if he had taken it personally he replied that sometimes these samples orders were sent in advance. He would go to the PRC to meet face to face with the selected manufacturer. A summary of the position was that the Taxpayer would receive an order, the witness would draw the necessary illustration on the samples order and take it to a manufacturer. After it had been delivered by the witness to the manufacturer the witness would negotiate face to face with the manufacturer. These sample orders were not sent unaccompanied as the manufacturers did not care for this and wanted to negotiate face to face.

3.2.1.5 Additional questions from the Taxpayer's tax representative:

The witness was asked as to how orders were initiated. He said that he went to the PRC at the beginning of each year to collect samples. The manufacturers had thousands of different styles and he would select samples of those styles he thought suitable and which he would send to the Taxpayer's customers. Customers would select one or more of the styles but, perhaps, want one or more modifications. A modification could be restricted to the logo on the sample and, if that was the case, a copy of the required logo would be sent to the Taxpayer. The witness would then make a sketch and incorporate the customer's instructions.

3.2.1.6 Additional questions from the Revenue:

The witness was asked to write the words 'sample' and 'embroidery' on a piece of paper and was then referred to the samples order. It was pointed out to the witness that this form had the customer's reference at the top right, and that above the largest illustration the words 'for colours combination, please refer to buyer's design drawing attached' appeared. It was also pointed out that the attachment had the words 'sample' and 'embroidery' written on it in the

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handwriting of an employee of customer A. The witness agreed the identity of the writer of the words 'sample' and 'embroidery' and agreed that the attachment had come from the customer.

### 3.2.1.7 Question from the Board:

The witness was further referred to the same samples order and asked if photographs were attached. Having volunteered that the Taxpayer had to make up coloured drawings, the witness replied in the negative and added that only a drawing was attached.

### 3.2.2 Second Witness

3.2.2.1 This witness is the financial controller of a company which was, until early 1987, the owner of one half of the issued share capital of the Taxpayer. He had held that position since mid-1985. He had been assigned to supervise the financial and accounting operations of the Taxpayer.

3.2.2.2 In those parts of his evidence, explained by documents to which the Board was referred, which the Board considers relevant, he explained:

3.2.2.2.1 In considerable detail his duties with respect to the Taxpayer.

3.2.2.2.2 The structure of the Taxpayer. This comprised three divisions, [X division], [Y division] and [Product Z division].

3.2.2.2.3 That part of the Taxpayer's income which was the subject matter of the appeal and which had been isolated in the Taxpayer's profits tax return related to all three divisions but by far the greatest proportion related to [X division] of which the first witness was the manager. He had prepared, and he produced, a schedule identifying the payers of the commission income during the relevant period. This schedule disclosed the commission received by each of the three divisions and the identity of the payers of the commission.

3.2.2.2.4 [X division] employed four people, including the first witness who was its manager and who had overall responsibility. The others were one senior assistant, who is familiar with the division's whole operations and two clerical staff who handle typing, filing and general office duties. Supporting service functions were provided to the Taxpayer by his employer referred to in paragraph 3.2.2.1 above, and related to shipping, administration, finance and accounting and computer facilities. Costs were allocated according to sales volumes and gross income.

3.2.2.2.5 The Taxpayer has two major sources of income, namely trading income from its business as an importer and exporter and the commission income. None of the commission income came from related parties.

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- 3.2.2.2.6 Most agreements with manufacturers and customers are not formalised in writing. However, there were two formal agreements:
- 3.2.2.2.6.1 One was between an associated company incorporated in Canada and one of the Taxpayer's principal manufacturers creating an exclusive agency agreement relating to the USA and Canada, referred to paragraph 3.2.1.2.6 above. There was an informal understanding that the Taxpayer could conduct business with that manufacturer on the same terms and conditions. This manufacturer was not prohibited from dealing directly with the Taxpayer's customers but, in practice, did not do so. Its contacts with the Taxpayer's customers were during visits by them to the PRC.
- 3.2.2.2.6.2 Another dated November 1981 related to commissions on product Z purchased by a resident of the USA through the Taxpayer. Under an informal agreement the Taxpayer received a 5% commission from both the manufacturer and the buyer.
- 3.2.2.2.7 The business procedures adopted by the Taxpayer with respect to trading transactions were then explained in detail.
- 3.2.2.2.8 He explained the distinctions between trading transactions and what he described as 'commission sales' in the Taxpayer's accounts as follows:
- 3.2.2.2.8.1 Commission sales – the customer knows the identity of the manufacturer and vice versa. They deal with each other on a principal to principal basis. Payment is made directly by the customer to the manufacturer and the Taxpayer raises separate invoices on each the customer and the manufacturer for its commission.
- 3.2.2.2.8.2 Trading transactions – whilst the customer may know the identity of the manufacturer, the manufacturer never knows the identity of the customer. Further, the title in the goods passes from the manufacturer to the Taxpayer which pays the invoice raised on it by the manufacturer.
- 3.2.2.2.9 The Taxpayer's [X division] cross-references trading documents and accounting records by maintaining a log of all transactions into which are posted the debit notes raised by the accounts department.
- 3.2.2.3 Cross-examination:
- 3.2.2.3.1 The witness was referred to an invoice to the Taxpayer from a Hong Kong manufacturer dated 9 March 1988 with its annexed 'inspection sheet' which he agreed was prepared by the first witness. He was unable to say whether or not inspection was required by the letter of credit. He agreed that the invoice related to a trading transaction and that the profit was taxable.

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3.2.2.3.2 When asked why the position was different with respect to the commission transactions, he said that it was because the first witness went to the PRC before shipment. When asked whether the first witness prepared a similar 'inspection sheet' for those transactions, the witness replied that if the letter of credit required one there would be one.

3.2.2.4 Re-examination:

There was no re-examination of the witness.

3.2.3 Third Witness

3.2.3.1 Throughout the relevant period the witness had been a director of the Taxpayer and the company which employed the second witness. His evidence was:

3.2.3.1.1 The schedule of commission income transactions prepared by the second witness contained reference to an European manufacturer, referred to paragraphs 3.2.1.2.5 and 3.2.1.2.40 above. The relevant part of the commission income arose from an introduction by the Taxpayer of a PRC resident buyer to the European manufacturer. The Taxpayer received commission on that transaction. The commission was paid by both the manufacturer and the buyer. The Taxpayer provided services to the manufacturer by communicating on its behalf with potential buyers. The manufacturer supplied samples to be shown to would-be buyers.

3.2.3.1.2 He was referred to a telex dated 9 November 1983 from the European manufacturer identifying concern with the packing of merchandise. The witness stated that the Taxpayer sent personnel to the PRC to negotiate orders. This involved knowing the manufacturer's prices and hand-carrying the manufacturer's samples. If the buyer wished to purchase, an order would be placed whereafter the Taxpayer would liaise with respect to the documentation. Occasionally a buyer required modifications before purchasing. No representative of the Taxpayer had ever visited the European manufacturer. He identified the Taxpayer's representative who went to the PRC, a Mr X, who was assisted by a Ms Y. The witness could not remember how often they went to the PRC but hazarded that it could have been once a month and either Mr X or Ms Y would visit the PRC.

3.2.3.1.3 He was then questioned with respect to the transaction involving the purchase of products D and E. The witness said that the Taxpayer introduced a customer to the manufacturer. After this introduction, orders were placed and the Taxpayer earned commission. Products D and E were inspected in Place Y, China but they were standard items. The standard of production in the PRC was not stable and goods need to be inspected. Inspections were by Ms Y. Shipment of products D and E was arranged by the manufacturer and directed

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to the buyer in the United States. The buyer had opened a letter of credit directly to the manufacturer and the Taxpayer's commission was paid after shipment. The Taxpayer received copies of the relevant shipping documents and was aware that the manufacturer had been paid whereafter it could render an invoice for its commission.

3.2.3.1.4 The witness was then referred to the commissions from two other manufacturers identified in the schedule produced by the second witness. He explained that the Taxpayer had introduced a US resident buyer of product Z to the manufacturer. The manufacturer provided the Taxpayer with samples and prices which were then passed on by the Taxpayer to the buyer. The buyer placed an order and the Taxpayer received commission of 5% from both the manufacturer and the customer. The Taxpayer sent people to the PRC to inspect the merchandise and the procedures were similar to the transactions involving the Taxpayer's [X division]. He added that the manufacturer of product Z was obliged to produce samples which were checked on receipt. This checking took place sometimes in the PRC and sometimes in Hong Kong. If the samples were satisfactory they would send to the USA. If they were not satisfactory they would return to the manufacturer. The checking was done by another employee, a Ms Z, not the first witness. He volunteered that Ms Z's trips to the PRC were not frequent, perhaps once a month, as there were only one customer and one manufacturer. There were a few styles of product Z but the witness could not be specific as to how many. Ms Z performed the necessary quality control inspections in the PRC. These were never checked in Hong Kong as they were shipped directly by the manufacturer to the customer. The Taxpayer provided no assistance with respect to the shipment of these goods.

3.2.3.2 Cross-examination:

3.2.3.2.1 The witness was asked if he had ever been involved with the Taxpayer's work in the PRC to which he answered that he was involved in China trading but he had nothing to do with the service side of the Taxpayer's operations.

3.2.3.2.2 He confirmed that the commission associated with the European manufacturer named in paragraph 3.2.3.1.1 above resulted from an introduction and that products D and E transaction was on a similar basis.

3.2.3.2.3 He agreed that the services with respect to product Z were rendered in the PRC.

3.2.3.2.4 The witness confirmed that the Taxpayer and the company of which the witness was a director were in the same group of companies and the Taxpayer used the staff of the company when necessary. He confirmed that these services were paid for. He also agreed that the commission was shared.

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3.2.3.2.5 The witness was reminded that the Taxpayer's tax representatives had advised the Revenue, by letter dated 30 December 1986, that the commission on product Z was shared. The witness stated that it was regarded as group income and that the Taxpayer's name was used to simplify the transaction.

3.2.3.3 Re-examination:

The witness was not re-examined.

3.2.3.4 Questions from the Board:

3.2.3.4.1 The witness confirmed that Ms Y went to Place Y, China to inspect the quality of products D and E and that the quantities for each order filled a twenty foot container. He could not remember the size of the two products. When referred to the schedule produced by the second witness, refers to paragraph 3.2.2.2.3 above, and asked if the \$116,356 had been paid back to the company referred to in paragraph 3.2.3.2.4 above or to a third party he was unable to answer. The representative of the Revenue referred the Board to a letter of 2 February 1988 from the Taxpayer's tax representatives to the Revenue which disclosed that \$45,168 had been paid to the said company and the balance to others.

3.2.3.4.2 The witness was unable to identify the buyer of the two above-mentioned products but said that he thought the transaction was to be through an entity other than the Taxpayer. However, he claimed not to be familiar with the transaction.

3.2.3.4.3 The witness confirmed that the first witness was in charge of product A and other products of [X division] for the European buyers and that merchandise was also sourced in Hong Kong and those contracts were also supervised by the first witness.

3.2.3.4.4 The witness stated that some 80% to 90% of the first witness' time was devoted to the PRC related work.

3.2.3.5 Additional questions from the representative of the Taxpayer:

When asked whether the first witness serviced the orders for the overseas customers listed in the schedule produced by the second witness, the witness replied that the Taxpayer got commission from all buyers of product A. He added that customers wanted the Taxpayer's services with respect to inspection but the commission income included payment for the inspection of product A.

3.2.3.6 Additional questions from the Revenue:

The witness disagreed that there was any income from products D and E transactions. He estimated the value of a container of the two products at

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between US\$12,000 and US\$15,000. When asked whether the commission income would be US\$1,200 the witness stated that there were different values but finally agreed that the commission on a container would be about US\$600. When asked how many visits had been made he answered that there were usually several containers. When asked to clarify that answer by reference to say twenty, forty or sixty containers he replied that the transaction in question was when the Taxpayer started. The transaction was not necessarily profitable but cost was not a consideration. The Taxpayer was trying to satisfy customers.

### 4. SUBMISSION ON BEHALF OF THE TAXPAYER

The Taxpayer's tax representative handed up a written submission through which the Board was taken. In synopsis the submission was:

#### 4.1 The nature of the Taxpayer's business:

The Board was reminded that throughout the relevant period the Taxpayer carried on business as an importer and exporter and that in the course of carrying on its business it also entered into commission agency agreements with overseas manufacturers and overseas buyers. In its agency business the manufacturers and the buyers always acted on a principal to principal basis with the manufacturers billing the buyers directly. The Taxpayer fulfilled certain services for which it billed both the manufacturer and the buyer, each being billed 5% of the invoice value of the transaction.

#### 4.2 The issue:

4.2.1 It was also common ground that the profits in question were not of a capital nature.

4.2.2 The sole issue is whether the profits earned by the Taxpayer during the relevant period were, in the wording of section 14:

‘... assessable profits arising in or derived from Hong Kong ... ’

The Taxpayer's position was that the issue should be decided in its favour.

#### 4.3 Section 14:

4.3.1 The Board was referred to the advance copy of the advice of the Judicial Committee of the Privy Council in CIR v Hang Seng Bank Limited in which it had been laid down that three conditions had to be satisfied, namely:

4.3.1.1 The taxpayer must carry on a trade, profession or business in Hong Kong.

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- 4.3.1.2 The profits to be charged must be ‘from’ such trade, profession or business; and
- 4.3.1.3 The profits to be charged must be ‘profits arising in or derived from’ Hong Kong.
- 4.3.2 It was common ground that the first two of the above conditions was satisfied whereby the sole issue is whether the third is satisfied.
- 4.3.3 The third of the conditions demonstrated that the tax is levied on a territorial basis, taxing only profits with their ‘source’ in Hong Kong.
- 4.3.4 The structure of section 14 presupposes that some of the transactions of a Hong Kong business may give rise to taxable profits (or relievable loss) and others to non-taxable profits (or non-relievable loss) depending on whether the source of the profit is located within Hong Kong or not, refer CIR v Hang Seng Bank Limited.
- 4.3.5 Questions as to the geographical derivation of profits (or losses) have to start with an enquiry about the derivation of the income, see CIR v Hang Seng Bank Limited.
- 4.3.6 Section 14 of the Ordinance also envisages that income may arise or derive entirely from Hong Kong – Hong Kong income, entirely outside Hong Kong – offshore income, or partly outside and partly inside Hong Kong – multiple source income.
- 4.4 The test:
  - 4.4.1 The test for determining if the first condition is satisfied differs from the test for determining if the third condition is satisfied.
  - 4.4.2 The first condition looks to the location of the business. Atkin L J’s ‘operations test’ in Smidth & Co Limited v Greenwood [1921] 3 KB 583 at 593 was formulated to deal with trade for the purposes of United Kingdom taxation and may be useful in deciding if the first condition was fulfilled.
  - 4.4.3 The third condition looks to the profit (or loss) generated by individual business transaction, refer CIR v Hang Seng Bank Limited. It is apparent from the advice that the Judicial Committee considered that this conclusion could be drawn from the way ‘assessable profits’ were to be calculated.
- 4.5 Locating source of income
  - 4.5.1 The Board was referred to a series of authorities and passages which were quoted extensively. These authorities were:

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- 4.5.1.1 CIR v Lever Brothers [1946] SATC 1
- 4.5.1.2 Commissioner of Taxation v Kirk [1900] AC 588
- 4.5.1.3 Lovell and Christmas Limited v Commissioner of Taxes NZ [1908] AC 46
- 4.5.1.4 Rhodesia Metals Limited v Commissioner of Taxes (SA) [1940] AC 774
- 4.5.1.5 Tariff Reinsurance Limited v Commissioner of Taxes (Victoria) 4 ATD 498
- 4.5.1.6 CIR v The Hong Kong and Whampoa Dock Co Limited [1960] 1 HKTC 85
- 4.5.1.7 Federal Commissioner of Taxation v United Aircraft Corporation 7 ATD 318
- 4.5.1.8 Federal Commissioner of Taxation v Mitchum 13 ATD 497
- 4.5.1.9 Esquire Nominees Limited v Federal Commissioner of Taxation 72 ATC 4007  
– On appeal 73 ATC 4115
- 4.5.1.10 Federal Commissioner of Taxation v Efstathakis 79 ATC 4257
- 4.5.1.11 Smidth & Co Limited v Greenwood [1921] 3 KB 583
- 4.5.1.12 Hillsdon Watts Limited v Commissioner of Taxation ATD 199
- 4.5.1.13 Bank of India v CIR 2 HKTC 503
- 4.5.2 In essence the submission of the Taxpayer was that it was the duty of the Board to determine what the Taxpayer had done to earn the commission income and where was it actually done.
- 4.5.3 The Board would obtain guidance from the advice in CIR v Hang Seng Bank Limited which, it was submitted was authority for the proposition that the stages in the process of determining assessable profits were as follows:
  - 4.5.3.1 First, it is necessary to examine each item of the taxpayer's income in the adjusted profit and loss account and decide if that income has a Hong Kong source or an offshore source. For example, fees earned for work done wholly outside Hong Kong is income arising in or derived from outside Hong Kong and has an offshore source.
  - 4.5.3.2 Secondly, having segregated the Hong Kong income from the offshore income it is necessary to examine each item of the taxpayer's expenses in the adjusted profit and loss account and decide to what items of income those expenses are attributable. This is necessary because expenses not incurred in the production

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of Hong Kong income (and thereafter Hong Kong profits) are not deductible in computing liability to Hong Kong profits tax.

- 4.5.3.3 After these two stages there will have been ascertained the amount of the income derived from Hong Kong, the expenses attributable to that income, and the amount of profit ('assessable profit') or loss with a Hong Kong source. (Also the amount of offshore income, the expenses attributable to that income, and the amount of offshore profit or loss).
- 4.5.4 The facts were then briefly rehearsed whereafter the Board was advised that:
- 4.5.4.1 The profits which have been assessed arose (or were derived) from services rendered wholly outside Hong Kong. No part of those profits arose in Hong Kong.
- 4.5.4.2 Whilst there were 'Hong Kong elements' in the transactions, such elements only arose because the Taxpayer had its centre of operations in (and so carried on business in) Hong Kong. This is not relevant in determining how a particular item of income arises. It cannot be the case that, because a company has its centre of operations in Hong Kong, this alone causes all its profits to arise in Hong Kong.
- 4.5.4.3 The Taxpayer's submission is that the profits which have been assessed arose outside Hong Kong and they fall outside the charge to profits tax imposed by section 14 of the Ordinance.

### 5. SUBMISSION ON BEHALF OF THE REVENUE

The submission of the Revenue was also in writing and the Board was taken through the submission. In synopsis the submission was:

- 5.1 The sole issue to be decided by the Board was whether the commission income constitutes, in the words of section 14:
- '... assessable profits arising in or derived from Hong Kong ...'
- 5.2 A subsidiary issue was the 'related exchange gain' for the years of assessment 1985/86, 1986/87 and 1987/88 which the Taxpayer's tax representative had agreed would follow the source of the commission income, which was confirmed.
- 5.3 The Taxpayer carried on a business of importing and exporting of textiles and as commission agent in Hong Kong. The Taxpayer's profits from its trading activities have been included in its profits tax returns as there was no dispute that those profits arose from a source within Hong Kong. The Taxpayer also earned the commissions income from acting in the capacity of an agent in

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concluding transactions between principals, primarily located in Europe and the PRC, for the purchase/supply of merchandise.

5.4 The representative then gave an analysis of section 14 and reminded the Board that the sole issue is whether the source was located wholly outside or wholly within Hong Kong.

5.5 How was the Board to decide the issue? The answer would be determined by what the Board factually saw as having been done by the Taxpayer to earn the commission income and the source would be located in the place where the Taxpayer performed the activity. The Board was then referred to a passage in the advice in CIR v Hang Seng Bank Limited:

‘But the question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last analysis a question of fact depending upon the nature of transaction. It is impossible to lay down precise rules of law by which the answer to that question is to be determined. The broad guiding principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profit in question.’

5.6 The Board was then referred to the definitions of ‘commission’ and ‘commission agent’ in Chambers Twentieth Century Dictionary.

5.7 The Taxpayer received a commission of 5% based on the invoiced value of goods for acting as a buying and selling agent. It was submitted, as a general proposition, that the activity which gave rise to the commission income was to arrange for business to be transacted between principals. The commission income arises when the transaction is concluded, namely on acceptance of orders obtained or placed through the agent, and the source of commission is the place where the activity of the commission agent was undertaken. It would be irrelevant for purpose of the Board’s enquiry to take into consideration the place where the principals were located or how they were identified by the Taxpayer, possibly many years ago. Equally irrelevant to the determination of the issue would be ancillary activities, if performed in respect of particular transactions, either prior or subsequent to the earning of commission on the transaction of business. To do so, as Lord Bridge says in CIR v Hang Seng Bank Limited, ‘would lead to an almost insoluble difficulty in distinguishing Hong Kong profits from offshore profits for the purpose of the assessment required to be made by the section’.

5.8 If that approach were to be adopted for the purpose of determination of the source of commission income in this appeal, it was submitted that the questions which arose would be as follows:

5.8.1 What is the nature of the income?

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- 5.8.2 What does the Taxpayer have to do to earn the commission?
- 5.8.3 What about other activities which the Taxpayer may have to perform before the commission is received?
- 5.8.4 As the commission is received from non-resident principals, should it be treated as arising offshore for this reason?

The Revenue's preferred answers to these questions were advised to the Board.

- 5.9 The Commissioner, for reasons stated in his determination, considered the activities of the Taxpayer which earned the income included essentially activities done with offshore manufacturers or buyers. Even though the nature of commission is distinguishable from a trading profit (as in Exxon Chemical International Supply S A v CIR 3 HKTC 57), nevertheless, a commission agent earns his commission by the transaction of business for another while a trader earns profit through transacting business on his own account. The authorities cited show that a profit by way of commission is derived in the place of the performance of acts which give rise to the commission. The transaction is concluded and the commission earned (a profit in the case of a trader) because of the Taxpayer's activity in:

- 5.9.1 receiving an order from the buyer in England (refers to paragraph 3.2.1.2.7 above);
- 5.9.2 placing the order with the supplier in the PRC;
- 5.9.3 obtaining the sales confirmation from the supplier in the PRC; and
- 5.9.4 obtaining acceptance of the supplier's sales confirmation from the buyer in England.

In the instant case all the activities of the Taxpayer took place in Hong Kong. The commission therefore arises in Hong Kong and any subsequent activities of the Taxpayer cannot alter or displace that fact.

- 5.10 The Taxpayer contended that various other activities were performed outside Hong Kong, although the Revenue could also point to other activities within Hong Kong, but such activities were either antecedent to the earning of the commission or subordinate services performed after the commission had been earned. Accordingly, such activities are not relevant considerations to the determination of source.
- 5.11 The conclusion which the Board was asked to draw in the appeal, based on what was understood to be generally accepted as the principle emerging from

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CIR v Hang Seng Bank Limited, is also strongly supported by the rationale of the decisions of the Board of Review and the Supreme Court in the case of CIR v International Wood Products Limited. In referring the Board to the facts and conclusions in that case, the Board was requested to note what was considered to be the prime cause for the receipt of commission, by whom and where the activity was undertaken and the reason why the source of commission was found to be located offshore. Based on the facts in this appeal, and by parity of reasoning, it was submitted that the source of commission must be determined to be within Hong Kong.

- 5.12 The Board should adopt the principle and reasoning enunciated in CIR v Hang Seng Bank Limited and CIR v International Wood Products Limited. The Taxpayer was required to transact business for its principals and it was from this, which had been done in Hong Kong, that the commission income was earned. If the Board were to go further and attempt to weigh in a balance any and all activities of the Taxpayer and others in order to decide whether there had been a preponderance of factors in favour of or against Hong Kong, then this would place the Board in a position of 'almost insoluble difficulty' in making the clear distinction which section 14 dictates. It may not be much that must be done to source income in a particular place, but the source is where that which is required to be done is done, refer to CIR v Hang Seng Bank Limited and the Exxon cases.
- 5.13 The arguments for the Taxpayer laid great stress on certain factors to support the contention for an offshore location of source for the commissions. It was submitted that these factors should be examined as follows:
- 5.13.1 When the terms of the contract have been agreed and manufacture has commenced the Taxpayer sent staff to the PRC once or twice a month to undertake quality control tests on the products. How crucial a factor, if relevant at all, was the quality control service rendered? The Board was urged to consider:
- 5.13.1.1 The Taxpayer conducts business under a general understanding and on the same terms as the agreements stated in paragraphs 3.2.2.2.6.1 and 3.2.2.2.6.2 above. In neither of those agreements is there any suggestion that the Taxpayer was to be paid for providing any quality control services. If they did, was the service provided on each transaction?
- 5.13.1.2 Among the product lines for which the Taxpayer transacts business are products Z, A, B, C, D and E. Bearing in mind repeat orders, the type of product lines, and the relatively small amounts of commission earned on individual transactions, it would appear unlikely that quality control was an important factor for the receipt of commission.

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- 5.13.1.3 In regard to commissions from the European manufacturer the question of any quality control service by the Taxpayer did not arise.
- 5.13.1.4 As to the ‘commission on [product Z]’ any quality control service is not an activity of the Taxpayer.
- 5.13.1.5 The Taxpayer takes positive steps to inhibit the principals from dealing directly with each other. What significance does the Taxpayer itself attach to the so-called quality control services if this is the case. This factor emphasized the crucial role of the Taxpayer as a commission agent rather than as one whose main role had been to render quality control services.
- 5.13.2 In the words of the Taxpayer’s tax representatives quoted in the Commissioner's determination:

‘... contracts that have arisen from the initial identification of the purchaser and are considered to be a continuing flow of income from the original source ... As neither the purchaser nor the manufacturer are resident in Hong Kong and as the Taxpayer concluded the initial agreements, albeit verbally, with the parties outside Hong Kong, the commission has been treated as not arising in or derived from Hong Kong.’

In order properly to construe section 14, the Board’s task is to consider the profits on individual transactions and these must be located only by reference to the gross profits accruing from those transactions, per Lord Bridge in CIR v Hang Seng Bank Limited. The question arises as to what profit arises from the initial identification of the purchaser or manufacturer? The answer is none and this factor alone in relation to source is equally irrelevant as is the fact that the Taxpayer carries on business in Hong Kong. In any event, during the period in question not one new buyer was identified by the Taxpayer. The profit only arose on transaction of particular business orders and neither the location of contracts, if offshore, nor locations of principals are relevant considerations to ascertainment of the source of commission, refer Exxon and International Wood Products Limited.

- 5.14 The onus of proving the assessment are incorrect or excessive is upon the Taxpayer, section 68(4). The authorities drawn to the Board’s attention all indicated that the Taxpayer has a hopeless case. It was submitted that the Taxpayer has failed to discharge this onus in respect of the individual transactions which give rise to the commissions whereby the Board should dismiss the appeal.

## 6. REASONS FOR THE DECISION

- 6.1 Onus of proof

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By virtue of section 68(4) of the Ordinance it is for a taxpayer to prove that the assessment appealed against is incorrect.

### 6.2 Duty of the Board

The duty of the Board is to endeavour to ascertain the facts which gave rise to the profits sought to be taxed and thereafter to determine whether or not on the facts found the provisions of the taxing legislation have been properly applied.

### 6.3 The interpretation of section 14 of the Ordinance

CIR v Hang Seng Bank Limited states that three conditions must be satisfied before a charge to tax can arise under section 14 of the Ordinance, namely:

6.3.1 The taxpayer must carry on a trade, profession or business in Hong Kong;

6.3.2 The profits to be charged must be from such trade, profession or business; and

6.3.3 The profits must be 'profits arising in or derived from Hong Kong'.

### 6.4 The question before the Board

6.4.1 There was no dispute before the Board that the Taxpayer carried on a business in Hong Kong.

6.4.2 There was also no dispute that the profits in question arose from the business the Taxpayer carried on in Hong Kong.

6.4.3 Accordingly, the sole issue before the Board was the source of the profits, that is whether or not the profits were 'profits arising in or derived from Hong Kong'.

6.4.4 The submission for the Taxpayer was that when considering the source of the Taxpayer's commission income during the relevant period the Board should accept that the commission arose from the performance offshore Hong Kong of services for both the manufacturers and the customers.

### 6.5 Source

6.5.1 It was not disputed by the Revenue that the income in question was commission income, as opposed to income from any form of trading in goods. Nor was it disputed by the Revenue that one half of this income was paid by the manufacturers with the other half being paid by the customers.

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6.5.2 The Board does not consider it necessary to rehearse in detail the authorities to which it was referred with respect to the determination of source save to say that it is for the Board to endeavour to find from the facts established to its satisfaction the answer to three questions:

6.5.2.1 What did the Taxpayer do to earn the commission income?

Whilst the commission income per transaction came from two sources, 5% from the manufacturers and 5% from customers, the Board notes that it arose from one transaction.

Unfortunately, one issue was not addressed by the parties, namely what would the Taxpayer have done if, after a manufacturer's sales confirmation and the Taxpayer's subsequent confirmation to the customer had been signed, either of them had declined to perform. The Board is in little doubt that the Taxpayer would have claimed its commission.

6.5.2.2 When was the commission income earned?

6.5.2.3 Where did the Taxpayer do what was required of it?

6.6 The evidence

Before reviewing the evidence to set out the facts established by the evidence, or the facts not so established, the Board feels obliged to comment that it was not taken through a particular transaction to illustrate how the Taxpayer arranged and administered a relevant transaction. Examples were drawn from various transactions. As an example; several communications during 1987 to and from customer A were referred to in the evidence but a sample order for one of their transactions related to one which took place in 1989, well after the relevant period. Further, no documentation was produced either to evidence the accuracy of the schedule of the first witness' visits to the PRC (although the Board records that it was told that the relevant visa book had been mislaid), or to demonstrate where and what the first witness did when he was in the PRC, for example receipts for travel and accommodation costs or memoranda prepared by the first witness and whether or not counter-signed by a manufacturer, and, in particular, identifying which trip(s) related to a meeting between the Taxpayer's principals, or which of them related to the first witness' annual visit to collect samples, to deliver any 'samples order', if indeed they were hand-delivered, to collect the resulting samples, if indeed they were collected, and to resolve disputes, if indeed he made any trips for such purpose.

6.6.1 There was no dispute that the commission income arose from the activities of three of the Taxpayer's divisions, namely [X division], [Y division] and [Product Z division].

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- 6.6.1.1 The first witness gave evidence based on his personal contributions to the generation of the income earned by [X division] and said that what he did was done by others in other divisions.
- 6.6.1.2 The second witness gave evidence as to the manner in which the Taxpayer handled all that detail necessary to maintain proper business records. However, his evidence does not assist the Board in answering the necessary questions.
- 6.6.1.3 The third witness gave evidence which, so far as it was directed to assisting the Board in resolving the issue, was not direct. In so far as his evidence related to what he actually knew, it related entirely to Hong Kong. His evidence as to what occurred within the PRC has to be taken by the Board as conjecture as he did not describe his evidence as to what other employees of the Taxpayer had done in the PRC as based on their reports to him.
- 6.6.2 The only evidence as to how the income of [X division] was earned is that of the first witness. Accordingly, a reasonably full record of his evidence is set out in paragraph 3.2.1 above.
- 6.6.3 The evidence of the first witness as to what he did for the manufacturers was very limited. A comprehensive synopsis of this aspect of his evidence is that at the start of each year he visited manufacturers, collected those of the many thousands of samples of lines he thought would be of interest to the Taxpayer's customers and hand-carried these samples to Hong Kong with a view to obtaining purchasers for those products. This was done from Hong Kong from where he communicated with the customers and awaited their response. The only conclusion that can be drawn from his evidence is that without the samples which he had collected from the manufacturers in the PRC the Taxpayer would not have been able to demonstrate to its customers that the manufacturers could supply a product of acceptable style and quality. Once an order was secured, the only other services provided to the manufacturers related to the consolidation of shipments from the PRC to Hong Kong and the transshipment thereof to Europe.
- 6.6.4 The first witness' evidence as to what he did after he returned from the PRC with the manufacturer's samples was so phrased by him as to convince the Board that he regarded the remaining services provided by him as provided for the Taxpayer's customers. In the view of the Board, the essential parts of his evidence were:
- 6.6.4.1 From Hong Kong, he sent those of the samples he had collected to those of the customers he thought would be interested in them and awaited their response. Apparently, he did nothing until the customers reacted. Reactions included requests for modifications, which could be limited to the logo or badge applied

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to a sample by the manufacturer or the manufacturer's choice of colours for the sample.

- 6.6.4.2 Having received in Hong Kong instructions from the customers he would prepare a sample order in Hong Kong. His evidence identified his original contribution to a samples order as the substitution of the Taxpayer's own code for the manufacturer's code and to translate into Chinese the customer's specific instructions.
- 6.6.5 The Board does not accept that part of his evidence as to the transaction in which he said that he had prepared drawings etc, refer paragraphs 3.2.1.1.10, 3.2.1.4 and 3.2.1.6 above. Quite clearly, the attachment to that sample order was created by the customer. The first witness' contribution was that of a translator.
- 6.6.6 The first witness would have the Board accept that, thereafter, on every occasion a sample order was prepared he went to the manufacturer in the PRC, explained the customer's requirements face to face and then returned to Hong Kong to return to the PRC when he was told the new sample was ready. The Board does not accept this part of his evidence. It is rejected for two reasons:
- 6.6.6.1 The schedule of the first witness' travel into the PRC does not support such frequent visits. An examination of this shows that between 1 April 1983 and 31 March 1984 he visited the PRC for the first time in May for eight days, including travelling time, then in June when the total time was twelve days, then in July when the total time was eight days and then in August when it was nine days. His next visit was in October when he went on three separate occasions with total times of four, three and four days. Thereafter, his visit were in November for a total of seven days and in February for a total of four days. The visits in the next year, were much the same and in the following year, 1985/86, his visits were less frequent. In 1986/87 his visits were much the same as in the first two years covered by this schedule. In 1987/88 his total time in the PRC, including travelling time, went up to ninety-two days, say one quarter of the year, on twenty separate visits the longest of which was nine days and several of which were of two days. However, that of itself does not fully support the first witness' claims. If he was servicing only one customer then, perhaps, that schedule would support such evidence. However, there was more than one customer and there was no suggestion by him that he timed his visits to the PRC to coincide with occasions when he had many potential samples to deliver or collect. The Board has already noted that there was no evidence attaching a particular activity to any one of these visits.
- 6.6.6.2 Several of the samples made after a sample order had been received by a manufacturer and which the first witness said he had hand-carried to Hong Kong and then forwarded to the customer were defective, at least in the sense that they did not strictly accord to the customer's requirements. The Board

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does not accept his explanation that he sent them because the deviations were trivial. A sample is intended to enable a buyer to see the precise appearance of a manufactured product. Factually, if the witness was at the factory, as claimed, and there was a minor deviation it would be easy for him to co-operate with the manufacturer's staff in producing a fully new conforming sample. With simple items such as product A, the Board does not believe that a new sample could not be manufactured within one working day or two working days at the most. Further, on one occasion the sending of the sample was a complete waste of time, refer paragraph 3.2.1.2.29 above. If the sample was patently defective it would have been only reasonable for the first witness to have rejected it on the spot. The fact that this sample was sent to customer A casts considerable doubt on the first witness' evidence as to samples made subsequent to receipt of a sample order being collected.

6.6.7 According to the first witness, once a sample was approved and an order received, documentation had to be prepared. First, the factory would be notified. Thereafter, after the manufacturer's sales confirmation was received, the customer's requirements would be acknowledged. Clearly, the manufacturer's sales confirmation was prepared by the manufacturer and although the first witness said it was signed in the PRC the specimen produced was signed by neither the manufacturer nor the Taxpayer nor the customer. However, those matters are irrelevant to the determination of this appeal. So far as documents prepared by the Taxpayer to be signed by the customer are concerned these were prepared in Hong Kong.

6.6.8 The first witness gave evidence as to visiting manufacturers with representatives of customers. His evidence was that at these meetings quantities and prices and delivery schedules were hammered out. It would appear to the Board that the witness' services at these meetings would have been that of an interpreter. This aspect of his evidence conflicts with part of his evidence as to substituting the Taxpayer's reference number for that of the manufacturers when forwarding samples to customers. His evidence was that one of the reasons for this was to prevent customers dealing directly with the manufacturers, refer paragraph 3.2.1.2.10 above. What is the point if the customers' representatives are to be taken by the witness to visit and negotiate with the manufacturers for the merchandise they wanted? The Board can appreciate why a trader keeps his suppliers and customers apart, namely to avoid the potential for being excluded from future or repeat orders and to prevent those parties from finding out his margin. However, the Taxpayer stood to benefit to the extent of 10% of every extra cent a customer agreed to pay. In this respect, it would appear to the Board that the first witness' recollection has confused those of his activities which were associated with the Taxpayer's trading activities and those associated with transactions from which the commission income arose.

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- 6.6.9 The first witness also gave evidence as to other services provided for the customers, namely quality control. He said that this was undertaken in the PRC, there being no alternative as the goods were packed for shipment before they arrived in Hong Kong for transshipment. It is common knowledge that cost factors dictate that the inspection of less expensive goods manufactured in quantity, such as the subject matter of those agreements giving rise to the commission income to which the Board was referred, is restricted, namely to the opening of a limited number of prepacked cartons selected at random with, perhaps, two, or maybe three or four of the items being selected at random from that carton to be checked for conformity to sample and, if so, the inspector presumes the balance to conform. The Board notes that there was no evidence that any customer advised the Taxpayer that it reserved its rights consequential upon any alleged negligent quality control services on the part of the Taxpayer, a fact which the Board accepts as indicative of the fact that the customers did not regard any such inspections as an obligation of the Taxpayer. Accordingly, the Board is obliged to accept that any such services were voluntary and designed to foster customer relations.
- 6.6.10 The first witness' evidence was that once the goods were in Hong Kong the services were no more than the physical and administrative effort to move the cartons into containers and obtain the necessary signatures on the pre-prepared shipping documents.
- 6.6.11 Invoices for commissions were prepared in and sent from Hong Kong.
- 6.6.12 The Board notes that there was no evidence that either the first witness ever considered it necessary or was ever requested to go to the PRC to chivy up a tardy manufacturer, although there were occasions when shipments were unduly delayed.
- 6.6.13 There remains one final 'service', namely the compromising of disputes as to the quality of delivered goods between the manufacturers and the customers. Whilst the Board was referred to documents which referred to such problems, the first witness gave no specific evidence as to how often they occurred and precisely how he obtained the agreement of a manufacturer to accept a reduction, save for one occasion when he referred to a telephone call. Accordingly, the Board is obliged to discount the relevance of this factor.
- 6.6.14 The Board also notes that there was no suggestion that the Taxpayer received any compensation from either manufacturers or customers for time and expense incurred in unsuccessful attempts to secure buyers for products or manufacturers of products.
- 6.6.15 The evidence of the third witness was, as already commented, of a restricted nature. However, part of his evidence was that the first witness spent between 80% and 90% of his time with respect to the transactions for the Taxpayer's

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European customers. The Board has already commented on the amount of time spent by the first witness in the PRC. Accepting the evidence of the third witness in this respect, it is perfectly clear that the overwhelming majority of the first witness' time was spent in Hong Kong.

### 6.7 The Questions

#### 6.7.1 What did the Taxpayer do to earn the commission income?

On the evidence, the Board is satisfied that the Taxpayer earned the commission income both by securing buyers for the manufacturers' products and by securing manufacturers to fabricate the specific products required by its customers.

#### 6.7.2 When was the commission income earned?

The Board is satisfied that the Taxpayer earned the commission income when the contractual obligations arose, namely when the necessary contracts had been delivered by and to its principals.

#### 6.7.3 Where did the Taxpayer do what was required of it?

On the evidence, the Board is satisfied that all material aspects of what the Taxpayer did to earn the commission income were all undertaken by the Taxpayer in Hong Kong.

## 7. DECISION

For the reasons given this appeal fails.