care to ensure that statements made in it are accurate and can be relied upon. The first page in the Prospectus of this Company contains a statement that the information contained in it is:—

> ". . . supplied by the directors of the Company who collectively and individually accept full responsibility for the accuracy of the information given and confirm having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission or inclusion of which would make any statement in this Prospectus misleading".

The Prospectus, therefore, militates against the Company's contention that the ground floor was held as an investment or capital asset. We have also been supplied with the Company's published Annual Report for 1973. The sale of the ground floor of this building is included in the Profit & Loss Account 1973 as "Profit from Operations". In our view these words do not suggest that the disposal of the ground floor was a sale of a capital asset. Indeed, the inference suggests the contrary.

If a dealer in land makes a representation that land dealt with is part of its trading asset, it amounts to an admission that the transaction is associated with the trade that is being carried on. When such admission is contained in a prospectus and the Annual Report of the Company in the following year confirms it by referring to the profit made as being from its "operations", the burden of proving otherwise is correspondingly heavier and, on the evidence, we are not satisfied that the Company has discharged that burden. We have also not been pursuaded to accept the Company's alternative argument that at the date of sale the Company converted an investment into trading stock. The assessment, is, therefore, confirmed.

Case No. BR 2/75

Board of Review:

Chan Ying-hung, *Chairman*, D. Barrett, B. S. McElney, & E. J. S. Tsu, *Members.*

5th May 1976.

Profits tax—taxpayer agent of foreign company under terms of agreement made in Hong Kong—whether operations giving rise to profits took place wholly outside Hong Kong—place where contract made and place where operations undertaken of important consideration but each case should be judged by its particular circumstances—Inland Revenue Ordinance, section 14.

Cessation of business under contract and commencement of new business under a new contract—whether assessment should be in respect of year of cessation or previous year.

Under an agency agreement dated the 10th June 1967, signed in Hong Kong, a Malaysian company appointed the taxpayer its foreign distributor of certain produce from Malaysia.

In pursuance of the agreement, the taxpayer procured two buyers and prices were agreed between these respective buyers and the Malaysian company and contracts were entered between them directly for all shipments made by the company. A monthly sales commission was paid by Malaysian company to the taxpayer based on the company's invoices to the buyers. The taxpayer also received a del credere commission from the buyers in consideration of the taxpayer guaranteeing the performance by the Malaysian company of orders placed with it. The agreement expired on the 9th June 1972, and on 10th June 1972 the taxpayer commenced business as advisory "Service Agents" for a Panamanian company under terms subsequently embodied in an agreement dated 20th January 1973 but expressed to come into operation on 10th June 1972. Under this agreement the taxpayer, in return for advisory services rendered to the Panamanian company, was paid a service fee of 5% of total expenses incurred by the taxpayer in providing the services.

The taxpayer was assessed to profits tax for the year of assessment 1972/73 of $916,157.00 and it appealed against that assessment on the grounds—

(*a*) that the profits arose outside Hong Kong because the operations which produced the profits took place outside Hong Kong and accordingly were not chargeable; and

(*b*) that if the profits were said to have arisen in or derived from Hong Kong, the assessment was wrong as there had been a cessation of its "distributorship" business on the 9th June 1972 and the commencement of a new business of "advisory services" on 10th June 1972 so that the taxpayer should have been assessed on profits for the year of the cessation and not those for the previous year as computed by the Assessor.

Decision: Appeal dismissed. Assessment confirmed.

A. B. Clarke for the appellant.

Osman Ghafur for the Commissioner of Inland Revenue.

Cases referred to:—

1. C.I.R. v. International Wood Products Ltd., H.K.T.C. 551.
2. Smith v. Greenwood, 8 T.C. 193.
3. Tariff Reinsurances Ltd. v. Commissioner of Taxes, 4 A.T.D. 498.
4. C.I.R. v. The Hong Kong & Whampoa Dock Co. Ltd., H.K.T.C. 85.

Reasons:

This is an appeal by a private company incorporated in Hong Kong (hereinafter referred to as "the Company") against a profit tax assessment for the year of assessment 1972/73 whereby the Company's profits were originally assessed by the Assessor at

$916,757.00. On objection being raised with the Commissioner, he reduced the assessable profits from $916,757.00 by $600.00 to $916,157.00. From this the Company has appealed. Perhaps it should be mentioned that before the Commissioner the Company also objected to an additional assessment for the year of assessment 1971/72 which revolved around a sum of $600.00 claimed as rebuilding allowance, but as the objection was allowed by the Commissioner, it does not form part of this Appeal.

When the Company first lodged its notice of appeal, the only ground relied on was that there had been a cessation of its "Exclusive Distributorship business" on the 9th June 1972 and the commencement of a new business of "Advisory Services" on the 10th June 1972 so that for the year of assessment 1972/73 the Company should have been assessed on the actual profits made in the year during which the cessation occurred in the sum of $230,638.00 and not the profits for the previous year which came to $909,287.00 as computed by the Assessor.

However, a few days before the hearing of the appeal a statement of certain alleged additional facts was received from the tax representatives of the Company, Messrs. Brandon Clarke & Co., from which it appeared that the Company was seeking to introduce a new ground, which, if upheld by us, would make it unnecessary to deal with the original ground. The new ground was that the Company's profits arose outside Hong Kong because the operations which produced such profits took place outside Hong Kong. This of course would render the profits tax-free.

In exercising the discretion vested in us under section 66(3) of the Inland Revenue Ordinance, we gave leave for the new ground to be included as one of the grounds of appeal with a clear warning from us that we expected the so-called further facts to be strictly proved because they had not been adduced or argued before the Commissioner.

As things turned out, the Company did not call any witness to give evidence but merely produced through its tax representatives a few agreed documents beyond those annexed to the Commissioner's determination. Accordingly we have disregarded any allegation of additional facts which is not supported or otherwise rendered probable by the documents admitted. Having considered all the evidence before us, we find the material facts to be as follows: —

(1) By an agreement dated the 10th June 1967 and signed in Hong Kong between the Company of the one part and

"N.A.K." of the other part, the Company was appointed by N.A.K. as its foreign distributor of logs, timber, rubber, palm oil and other forms of produce from Malaysia with the exclusive right to sell the same outside Malaysia.

(2) Under this agency agreement the Company received: —

(*a*) A sales commission paid by N.A.K. which was claimed monthly by the Company based on N.A.K's invoices to the buyers of which copies were sent to the Company;

(*b*) A del credere commission from the buyers in consideration of the Company guaranteeing (if required) the performance by N.A.K. of orders placed with it, such commission being claimed also monthly; and

(*c*) "Despatch Money" for prompt discharge of cargo paid by N.A.K. or by the buyers for its account.

(3) In pursuance of the said agreement, the Company procured two buyers in Japan, who bought regularly from N.A.K. Prices were agreed between N.A.K. and the buyers and contracts were entered into between them direct for all shipments made. Payment was made by the buyers by letters of credit opened in favour of N.A.K. Goods had to be inspected by the buyers at the port of loading before each shipment was made. The Company was not aware of the contracts made until after the event when copies of invoices were sent to the Company by N.A.K.

(4) The Company undertook with N.A.K. to place with it orders of not less than 2½ million hoppus per annum.

(5) The Company commenced on the 26th August 1967 to carry on the business which came into being as a result of the said agency agreement. The agreement was to remain in force for a term of five years. It was not renewed on its expiry on the 9th June 1972.

(6) On the 10th June 1972 the Company commenced to carry on a business of Service Agents which consisted of the Company rendering to a company incorporated in Panama called SA relating to technical, financial, selling and administrative matters. Their business was conducted in accordance with terms and conditions subsequently embodied in a written agreement dated the 20th January 1973 in which the Company is described as

"Service Agents" and SA as "Principals". The service agreement contains a recital that it had in fact come into operation as from the 10th June 1972.

(7) A meeting of the Directors of the Company was held on the 20th January 1973 when it was resolved that the service agreement referred to be entered into and that the Company act as Service Agents in East Asia for SA for a period of five years from the 10th June 1972. The agreement in fact so provides.

(8) Under this service agreement, apart from the advisory services described above, the Company was to keep and maintain such office or offices "staffed by such employees as may be required" and SA agreed to reimburse the Company all expenses directly or indirectly incurred by the Company in performing its services as provided in the agreement. In return the Company was to be paid a service fee of 5% of the total of the expenses mentioned.

On these facts, Mr. Brandon Clarke contends that the Company's profits arose in or were derived from operations outside of Hong Kong and consequently are not subject to tax. In support, he cites the case of **C.I.R. v. International Wood Products Ltd.**[1].

Mr. Osman Ghafur, Acting Chief Assessor who appeared on behalf of the Commissioner, argues that the operations relied upon by Mr. Clarke are activities on the part of N.A.K. and the Japanese buyers and not operations undertaken by the Company in earning the income brought into charge. In his submission, the source of the income in this case is the agency agreement dated the 10th June 1967 and such source is in Hong Kong. According to him, the test of "where do the operations take place from which the profits in substance arose" laid down by Atkin L.J. in **Smith v. Greenwood**[2] is not relevant in this case. Instead, he invites us to follow the decision of **Tariff Reinsurances Ltd. v. Commissioner of Taxes (Vic.)**[3] which was cited with approval by the Full Court in **C.I.R. v. The Hong Kong & Whampoa Dock Co. Ltd.**[4].

In the **Tariff Reinsurances case**[3], an English company which carried on a reinsurance business in England entered into a contract in England with a company in Victoria to accept reinsurances

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1 H.K.T.C. 551.
2 8 T.C. 193.
3 4 A.T.D. 498.
4 H.K.T.C. 85 at p.p. 108, 109.

of a portion of the risks accepted by the Victorian company. Under the contract, the company in England was entitled to receive a percentage of the gross premiums received by the Victorian company which was to be paid to the English company with the Bank of New South Wales at its branch office in Melbourne. It was held by the Full Court of Australia that the profits of the English company was not derived from a source in Victoria.

Latham C. J. at p. 502 says: —

> "In this case the contract for reinsurance was made in England and that fact is an important element in the determination of the question which arises. Further, the profits were derived from that contract and were not derived from the insurance operations of the Victorian company in Victoria . . .".

Rich J. at p. 504 says: —

> "To my mind the source of the reinsurers' income is a contract constituting a reinsurance treaty made in London in the ordinary course of a business carried on in London".

That part of the judgment of Latham C.J. quoted above was referred to by Reece J., who delivered the leading judgment of the Full Court in the **Whampoa Dock case**[4], in these terms (p. 120):—

> "This would seem to be positive authority for stating that the place where the contract was made is of undoubted importance in determining where the profits in question arose or derived from, . . .".

It must be borne in mind that in the **Whampoa Dock case**[4], a salvage contract was made in the Paracels and salvage operations were for the most part performed outside the Colony. The Full Court decided that the profits were not subject to tax because they did not arise in or derive from the Colony. As Reece J. says in another part of his judgment (p. 112): —

> "It seems to me that in this case the contract of salvage . . . is a very important element to be taken into consideration in determining the source of the profits in dispute. Had that contract not been entered into there is no question that there would have been no profits to assess.".

Let us now examine the case of **C.I.R. v. International Wood Products Ltd.**[1]. It is a case in which a company in Hong Kong was appointed by an agreement made in the Philippines agents of two Philippine companies for the sale of logs to various places outside Hong Kong. The Hong Kong company in turn appointed sub-agents at various places outside Hong Kong to find buyers

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[1] H.K.T.C. 551.
[4] H.K.T.C. 85.

for such logs. Once appointed, the sub-agents were in direct communication with the Philippine companies. They solicited and obtained orders from buyers, negotiated the purchase prices and made arrangements for shipment as well as for payment. With the exception of a few instances held by the Court to be immaterial to its decision, payment was made by letters of credit direct to the Philippine companies. On these facts, Blair-Kerr J. held that the profits arose from operations which took place outside the Colony as there was no evidence that the taxpayer provided any services or that the profits were attributable to services provided by the taxpayer.

At first sight, the case seems to be very similar to the one before us. On closer examination, however, it will be seen that there are several important features which distinguish it from the instant appeal. In the first place, in the case before us, the contract by which the Company was appointed sole distributor was executed in Hong Kong. Secondly, the 2 buyers were procured by the Company and put in touch with the sellers by the Company in pursuance and performance of a Hong Kong contract. Thirdly, far from all the operations having taken place abroad, important services were rendered by the Company in Hong Kong without which there would have been no sales from N.A.K. and consequently no profits. We have in mind the undertaking given by the Company to place or cause to be placed with N.A.K. orders of not less than 2½ million hoppus per annum. This is undoubtedly an obligation of a fundamental nature and one which is enforceable against the Company in Hong Kong. Then we have the provision whereby the Company agrees to guarantee (if so required) to its customers performance of orders placed with N.A.K. This again is an obligation undertaken by the Company enforceable in Hong Kong. It makes no difference whether we call these obligations operations or services. What is certain is that they constitute major considerations moving from the Company for the agency agreement which, in our view, is the source of the profits made by the Company.

The law, as we see it, is that the place where a contract is made and the place where the operations producing the profits are undertaken are both important considerations. However, there is no principle which is universally applicable, and each case must be judged by its particular circumstances (**Whampoa Dock case**[4], at p. 109). Taking into consideration the totality of

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4 H.K.T.C. 85.

the circumstances in this case, we are of the opinion that the profits arose in or were derived from Hong Kong.

There remains the point whether there was a cessation of the Company's business under the agency agreement with N.A.K. when it expired on the 9th June 1972. Mr. Clarke submits that the Commissioner himself recognized that the services rendered by the Company before and after that date were of different natures, and that there was a cessation of its "Exclusive Distributorship business" on the 9th June 1972 and a commencement of the "Advisory Services" business on the 10th June 1972. He emphasizes that the two types of business are widely divergent and argues that no significance should be attached to the fact that the original staff and office premises were maintained.

Mr. Ghafur on the other hand, contends that the Commissioner's determination that the Company's business was to obtain contracts for the provision of services and to earn profits by rendering services in fulfilment of such contracts is a correct one. In his submission, there was a pattern of continuity in the Company's basic operations—that of securing contracts for the provision of services and to make a profit from such operations, and it makes no difference whether such services were rendered as distributing agents or as agents providing secretarial services. He also stresses the fact that there was no disruption in the Company's organization as a result of the expiration of the first contract.

Like the Commissioner, we also take the view that it would be taking too narrow a view of the Company's business to say that because the type of service provided under a contract has changed there must have been a cessation of the original business and the commencement of another. To earn income by providing services under long term contracts appears to constitute a business within which there can be room for changes in the nature of the services rendered and the manner as well as the capacity in which they are provided. It would be unrealistic to subdivide the classification of the business of a trading company to such a fine point that every time when a change occurs in the nature of any business within an object clause of its Memorandum of Association there is a cessation of such business.

The commencement or cessation of a business is a question of fact and in this respect we find among the documents submitted to us by the Company a letter dated the 10th January 1974 setting

out the prices offered by one of the buyers for the purchase of logs from N.A.K. for the month of December 1973, long after the Company is supposed to have ceased to deal with N.A.K. The existence of such a letter was never satisfactorily explained to us. Then there is the fact that in the minutes of the Board Meeting held on the 20th January 1973, more than 7 months after the business had supposedly ceased, all that was recorded was that the "Sales Agreement" with N.A.K. Co. Ltd. had not been renewed. No mention was made that the business had ceased—a fact which could have been easily proved by calling a director or officer of the Company. In the circumstances, we have been left with considerable doubt in our mind, and we must hold that the Company has failed to discharge the onus of proving that there was a cessation in the Company's business as claimed.

In view of the conclusions we have come to, the appeal is dismissed and the assessment for the year of assessment 1972/73 as determined by the Commissioner is confirmed.

Case No. BR 6/75

Board of Review:

L. J. D'Almada Remedios, *Chairman*, K. H. A. Gordon, Wong Tok-sau & A. Zimmern, *Members*.

19th December 1975.

Profits tax—company acquired property fit for redevelopment but sold it without redevelopment—profits on sale assessed to tax—whether property was a capital or trading asset.

The appellant, a company having as its principal objects the acquisition and development of and investment in land, purchased a piece of property fit for redevelopment purposes. No redevelopment was carried out and the property was subsequently sold. On being assessed to profits tax in respect of the sale the appellant claimed that the property should be treated as a capital asset on the grounds that it was acquired with the intention of redevelopment so as to obtain rental income, and that abandonment of the scheme for redevelopment resulted from the failure of Government to indicate what part of the property had to be surrendered for road-widening purposes. On Appeal.

Decision: Appeal dismissed. Assessment confirmed.

Kenneth K. C. Wong for appellant.

Chan Kam-cheong for the Commissioner of Inland Revenue.