CACV 86/2011

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF APPEAL
CIVIL APPEAL NO. 86 OF 2011
(ON APPEAL FROM HCIA NO. 3 OF 2010)

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BETWEEN

COMMISSIONER OF INLAND REVENUE Appellant

and

LI & FUNG (TRADING) LIMITED Respondent

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Before: Hon Tang VP, Hartmann JA and Chu JA in Court
Dates of Hearing: 14 and 15 February 2012
Date of Judgment: 19 March 2012

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J U D G M E N T

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Hon Tang VP:

Introduction

1. The taxpayer, Li & Fung (Trading) Ltd ("LFT") is incorporated in Hong Kong and wholly owned by LFBVI (a BVI company).

2. By a determination dated 14 June 2004 ("the Determination"), the Commissioner of Inland Revenue ("the Commissioner") required LFT to pay additional

profits tax or profits tax amounting to about $110 million for the years of assessment, 1992 to 2002.

3. LFT objected to the assessments on the basis that the relevant profits were offshore in nature and not chargeable to profits tax.

4. It is common ground that LFT's business included services which it provided to its customers who are importers, department stores, chain stores and specialty shop located overseas ("the customers") for which, typically, LFT was paid 6%[1] of the FOB value of the goods supplied to such customers. The assessments relate to profits thus derived.

5. A standard contract with the customers under which such services would be provided ("the standard agency agreement"), contained the following terms:

> "1 The Agent (LFT) is hereby appointed non exclusive buying agent of the principal for the purchase of merchandise on the terms and conditions herein contained from Hong Kong, Macau, Peoples Republic of China, Taiwan, Korea, Philippines, Thailand ...
>
> 2. a) The purchase price for the merchandise shall be FOB the country of origin unless otherwise agreed by the Principal.
>
> ……
>
> c) Unless otherwise specifically arranged between the parties payment for all purchase of merchandise by the Principal shall be by transferable, irrevocable Bankers' Documentary Credit to be established in favour of the Agent …
>
> 3. The services performed by the Agent are as follows :-
>
> a) Locate Suppliers, arrange manufacture, place orders in the Territory on the behalf of the Principal under the Principal's standard terms & conditions of trading. The Agent shall have no authority to place an order for goods without having first received prior written authorisation from the Principal.
>
> b) Keep close contact with the Suppliers to ensure that production is running according to the delivery schedule set by the Principal for each item.

[1] On appeal to Reyes J and us, the parties have proceeded on the basis that LFT was paid 6%. That was not invariably the case, it could be higher (7% was the figure used before the Board).

c) Maintain quality control on merchandise including inspection on a random basis to ensure that items being produced conform to the Principal's requirements.

d) Arrange for the shipment of the Merchandise under instruction of the Principal, including assisting the Supplier where necessary with the preparation of all relevant export documentation.

e) Attempt to settle possible merchandise claims on behalf of the principal.

f) Endeavour to keep Principal advised from time to time of new developments in markets of the Territory which may be of interest to the Principal.

g) Sign or countersign contracts/purchase orders/commitment on Principals behalf.

For such services as described in a) to g) above the Principal will pay the Agent a commission of 6% (six percent) on the FOB value of the merchandise at the time of payment as stated in point 2c."

6. LFT in turn entered into contracts with local companies ("the standard affiliates contract"), typically its affiliates, under which the local companies would provide services to LFT in return for 4%[2] the FOB value on these terms:

"(a) to research and locate suppliers for products and goods which the Company may require from time to time and generally to coordinate the supply of and demand for products provided by the Company between suppliers and customers and to advise the Company in respect of sourcing of products;

(b) to furnish continuous information concerning products availability, market conditions, and, in particular, information concerning the Company's suppliers and advise on matters of pricing;

(c) to arrange and obtain samples of products from suppliers and to assist the Company's suppliers with any problems relating to the exportation or application for export license of goods;

(d) to assist and advise on methods of transporting, storing and delivery of goods from the Company's suppliers and to provide advice regarding packaging systems and materials most suitable for goods;

[2] As with the 6% referred to in para 4 above, the parties have for the present purpose proceeded on the basis that these local companies were paid 4%.

(e) to assist the Company in investigating and settling any claims and complaints against products or goods supplied;

(f) to arrange for the packaging and shipping of the goods or products as shall be purchased by the Company and/or its customers and to act on and in accordance with the instructions of the Company in connection with such matters;

(g) to provide inspectors to monitor quality control of products offered by the Company whenever such quality control services are required by the Company in Thailand;

(h) to do such other acts and things as the Company and LFTL shall from time to time mutually agree."

7. There was also an agreement made between LFT and LFBVI under which LFBVI agreed to provide, for example, "promotional and marketing services outside of Hong Kong" for which LFT agreed to pay LFBVI "a fee calculated at 2% of the FOB value of all export sales made by the Company".

8. The agreement to pay this fee to LFBVI was also the subject of the Determination. There, the Commissioner concluded that the payment of such fees to LFBVI was part of a transaction under section 61A of the Inland Revenue Ordinance (Cap 112) ("IRO") entered into or carried out for the sole or dominant purpose of obtaining tax benefits.

9. On the taxpayer's appeal to the Board of Review ("the Board"), the Board held in favour of the taxpayer in respect of the source of income point and against the taxpayer on section 61A[3].

10. On 19 March 2010, the Board stated the following questions of law for the opinion of the Court of First Instance:

"(1) Whether, on the facts found by the Board, the true and only reasonable conclusion contradicts the Board's conclusion at paragraph 86 and paragraph 95 of the Decision, namely all of LFT's disputed profits were sourced outside Hong Kong and no apportionment would arise?

(2) Whether, on the facts as found by the Board, the Board's conclusion (at paragraph 144 of the Decision) that LFT and LFBVI entered into or carried out the transaction as identified by the Board in paragraph 99 of

[3] The Decision of the Board was delivered on 12 June 2009 although the hearing had concluded on 19 January 2006.

> the Decision for the dominant purpose of enabling LFT to obtain a tax benefit is contrary to the true and only reasonable conclusion?"

11. By agreement of the parties, the 2nd question has been deferred pending remittal of certain matters to the Board.

12. Reyes J answered the first question in favour of LFT and this is the Commissioner's appeal.

The law

13. The legal principles are not disputed and can be stated briefly. On the question where the profits was sourced,

> "one looks to see what the taxpayer has done to earn the profit in question and where he has done it." *CIR v HK-TVB International Ltd (P.C.)* [1992] 2 AC 397 at 407C.

14. As Bokhary PJ said, with the agreement of the other members of the court, in *Kwong Mile Services Ltd v CIR* (2004) 7 HKCFAR 275 at 283G:

> "… The situations in which the source of a profit has to be ascertained are too many and varied … the only constant is the need to grasp the reality of each case, focusing on effective causes without being distracted by antecedent or incidental matters."

15. Ribeiro PJ make it clear in *ING Baring Securities (Hong Kong) Ltd v CIR* (2007) 10 HKCFAR 417 that one should not:

> "53. … investigate every facet of the Taxpayer's business so that it could engage in a qualitative assessment of the relative importance of its various operations, choosing 'the more important things done' towards the generation of those profits as the criteria for determining geographical source. … (that) places an erroneous emphasis on matters properly regarded as antecedent or incidental to the profit-generating operations."

otherwise, one

> "50. … emphasises antecedent or incidental matters that, while commercially essential, are legally irrelevant. …"

Reyes J's Judgment

16. Reyes J noted that the LFT's case before the Board was that it engaged or acted through its local affiliates

> "9. … in performing the services which LFT has contracted to provide to its customers.
>
> ……
>
> 14. In contrast, the Commissioner argued before the Board that LFT's profit was the difference between the 6% which it received from its customers and the 4% which it paid to its affiliates. The Commissioner suggested that LFT operated a 'supply-chain management business'. In consequence, whereas LFT's affiliates earned their 4% for activities abroad, LFT (the Commissioner reasoned) earned 2% for managing its own activities and those of its affiliates from LFT's Hong Kong headquarters.

17. And that the Commissioner's case was rejected by the Board who:

> "16. … held that LFT was 'a commission agent'. LFT's business was 'that of undertaking, on behalf of its own customers, the sourcing of merchandise for its customers'. In short, LFT 'sold services for commission'."

18. Reyes J went on to note the relevant findings of the Board and that the Board in coming to its conclusion had followed the decision of the Court of Final Appeal in *ING Baring*.

19. Reyes J then turned to consider what he described as the Commissioner's reformulated case in the appeal[4] saying that the Commissioner no longer pressed the submission that LFT was carrying on a "supply-chain management business". Instead, Mr Benjamin Yu, SC (who, with Mr Eugene Fung, appeared for the Commissioner below as well as before us) argued that the Board had erred in not apportioning the gross profit of 6% which LFT received from its customers, which Mr Yu submitted:

> "33. … was earned as a result of activities carried out both in Hong Kong and abroad. Insofar as non-Hong Kong based affiliates were involved, Mr. Yu accepted that some of LFT's profit had an overseas source. On the other hand, insofar as LFT managed and supervised its affiliates from Hong Kong, part of LFT's profits (Mr. Yu argued) must have had a Hong Kong source."

[4] (paras 32-38) which he analyzed and rejected in paras 39-56 of his judgment. It should be noted that this reformulated case was not contained in the Commissioner's counsel's skeleton submission but was advanced orally.

20. Also Mr Yu complained that the Board had failed:

> "35. … to consider each of the activities (a)-(h)[5] set out in the standard agency agreements between LFT and its customers. Had the Board done its job properly, it would have appreciated that, as a matter of fact, activities (a)-(d) required certain matters to be done or resources to be maintained in Hong Kong to enable a 6% commission to be successfully earned."

21. Reyes J then went on to deal with each of the relevant activities[6] and concluded that insofar as LFT maintained back-up or support services for its affiliates at its Hong Kong headquarters, the Board was entitled to disregard them as antecedent activities which although:

> "42. … commercially essential to the operations and profitability of [LFT's] business … do not provide the legal test for ascertaining the geographical source of profits.".

22. In relation to Mr Yu's complaint that the Board had failed to analyse what specific operations were involved in carrying out activities (a) to (e), and in its duty to make findings as to which specific operations within those activities (a) to (e) took place in Hong Kong and which did not, Reyes J was of the view that if the Board had embarked on such an investigation that would have been to engage in what was described in *ING Baring* as a "legally irrelevant" exercise. The learned judge also compared Mr Yu's argument with the

> "50. … 'brain analogy' which the CFA criticised in *ING Baring* …"

and said:

> "51. … To my mind, Mr. Yu is saying no more than that at the material times LFT's senior administrative staff based in Hong Kong oversaw the activities of various overseas affiliates within the Li & Fung group. That fact alone (the CFA has said in *ING Baring* …) is not an appropriate criterion for ascertaining the geographical location of a profit."

23. Reyes J then concluded that:

> "55. … the Board's findings and conclusions on the source of LFT's profits are unassailable. There is no basis for saying that the Board ought to have apportioned the 6% commission in the way Mr. Yu suggests. Nor can it be said that the Board acted irrationally or that its conclusions were unsupported by the available evidence."

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5 See clause 3 reproduced in para 5 above.

6 Mr Yu only relied on activities (a) to (e).

24. With respect, I agree with Reyes J. His conclusion is amply justified by the Decision, and supported in particular by the following paragraphs in the Decision:

> "Board's decision on source of profits
>
> 75. Mr Goldberg told us we were only concerned with the third factor in *Hang Seng*, i.e. whether the profits were 'profits arising in or derived from' Hong Kong.
>
> 76. On the question whether LFT was a commission agent or a buyer and seller of goods, Mr Milne did not seem keen to argue that LFT was not a commission agent. With respect, he was clearly correct. We are satisfied by the agreements made by LFT with its customers, the placement memoranda, the placement reports and the oral evidence of John Arthur Heaviside, Phanprapaivadee Suchato, Danial Christian Deyoe, Mohammad Tofazzal Ali, Duangtida Ingsatht and Vajara Tanthanathip that LFT was a commission agent. We find as a fact that appellant's business was that of undertaking, on behalf of its own customers, the sourcing of merchandise for its customers. In other words, its sold services for a commission.
>
> 77. However, Mr Milne did argue that the local LF sourcing companies were sub-contractors of LFT, not its agents.
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> 78. Based on the sample documentation, and in particular, the agreements made between LFT and the local LF sourcing companies, we find as a fact that the local sourcing companies were LFT's agents.
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> 79. In any event, whether the local LF sourcing companies were LFT's agents or sub-contractors does not affect the correct resolution of the issue of the geographical location of LFT's profit producing transactions. It is not in dispute that LFT employed the local LF sourcing companies to act for LFT in carrying out transactions for customers. Thus, LFT's profits were earned in the place where the local LF sourcing companies carried out LFT's instructions, whether they did so as agents or principal, see *ING Baring Securities*, per Lord Millett at paragraph 147. For this reason, we are unable to accept Mr Milne's submission we should not be looking at the local LF sourcing companies' activities.
>
> 80. Mr Milne also argued that we are not concerned with gross receipts, but with gross profits. Assuming that it was open to Mr Milne to so argue and also assuming that he was correct, LFT contracted to render a service to its customers, and its net commission, after paying the local LF sourcing companies 4%, arose in the place where it rendered it, i.e. offshore, see *ING Baring Securities*, per Lord Millett at paragraph 145, where his Lordship said (emphasis added):-

> ' In Mehta the taxpayer's profits in those cases where he acted for clients consisted of the net commission representing the difference between the commission he paid to the brokers who carried out the transactions (which was an expense) and the larger commission he charged to his own clients. His right to retain the net commission was a contractual right which arose under the contract with his client. But the geographical source where his profit arose was not the place where the contract was entered into (which was Bombay) but the place where it was performed. He contracted to render a service, and the net commission arose in the place where he rendered it: see the passage previously cited in the opinion of Lord Bridge in Hang Seng Bank.'

81. Further, in view of our finding that the local LF sourcing companies were LFT's agents, the issue cannot arise.

82. Mr Goldberg also pointed out that LFT's accounting treatment was reproduced in the Determination without challenge and that it was not open to CIR to do so in her final submission. He went on to submit that when a trader bought and sold an asset, a gross profit was established by deducting the cost of the asset from its sale proceeds to arrive at the gross profit. However, in a service industry there was no asset cost to deduct above the line and there were and could only be the costs of earning receipts which were all overheads and below the line deductions. We accept Mr Goldberg's submission.

83. The focus is on establishing the geographical location of LFT's profit-producing transactions themselves as distinct from activities antecedent or incidental to those transactions.

84. Clause 3 of the sample agreement made with Mackeys referred to in paragraph 54 above provided that Mackeys would pay LFT 'a commission of 6% (six percent) on the FOB value of the merchandise'. LFT contracted to provide services. The profit producing activities or services started from the placement of orders by LFT's customers with suppliers, continued throughout the whole process of the production of the merchandise until the successful conclusion of the orders by shipments of the merchandise to the customers and in some cases continued further until the conclusion of follow-up services. It was through those transactions or activities that LFT earned its commissions and charges which were payable only after the completion of the shipment of the merchandise. LFT employed the local LF sourcing companies to act for LFT in carrying out these profit producing activities or services. It mattered not whether the local LF sourcing companies were LFT's agents or sub-contractors. We find as a fact that all the profit

producing/making activities/transactions took place outside Hong Kong. We further find that the geographical source of LFT's net commission representing the difference between the commission it paid to the local LF sourcing companies which performed the sourcing services and the larger commission which it charged to its own customers arose outside Hong Kong.

85. As LFT contracted to provide services, our finding in paragraph 84 above is in line with the guiding principles, see *Hang Seng* at pp. 322 - 323 and *ING Baring Securities*, per Lord Millett at paragraph 147.

86. We conclude with our finding that the disputed profits were all sourced outside Hong Kong. Thus, no question of apportionment arises. We should add that neither Mr Goldberg nor Mr Milne was really interested in apportionment."

This Appeal

25. Mr Yu confirmed that the essence[7] of the Commissioner's case is stated in para 38 of his skeleton argument which reads:

"38. … since the services performed by LFT in Hong Kong were part of the profits-producing transactions (because they were expressly agreed to be so under the LFT/Customer Contracts), the matters which the CIR relies upon cannot be described as antecedent or incidental matters."

26. He relied on the fact that the standard agency agreement provided that for the activities set out in clause 3, LFT would be paid a commission. He submitted that some of such activities took place in Hong Kong and any profit attributable to them are therefore taxable.

27. It is not surprising that Mr David Goldberg, QC, who appeared for LFT with Mr Stewart Wong SC, commenced his submissions by remarking on the protean nature of Mr Yu's advocacy. The para 38 argument is a refined version of the reformulated argument.

28. We have a copy of Mr Yu's skeleton submission dated 31 March 2011 prepared for the hearing before Reyes J. Mr Yu has confirmed that this point which is central to its appeal was not raised in the written skeleton. The reformulated argument was raised for the first time orally before Reyes J on 6 April 2011. Nor had counsel (who then appeared for the Commissioner)[8] taken either point before the Board.

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[7] Mr Yu accepted that para 38 is central to the appeal. I will refer to his argument as the "para 38 argument".

[8] Mr David Milne QC and Mr Eugene Fung.

29. Mr Yu submitted the Board ought to have asked itself whether any of the activities under clause 3 was performed in Hong Kong, and if so, how much. The Board should go on to decide that tax would be payable on the profits attributable to the services performed in Hong Kong, and apportion such profits accordingly[9].

30. Mr Yu submitted that insofar as the Board has failed to do so, we should remit the matter to them for further consideration. Although Mr Yu pointed to the fact that in *ING Baring* the Court of Final Appeal felt able to determine factual issues itself, he accepted that this is not such a case since we are not in a position to make the factual findings which are essential to the para 38 argument.

31. This is not a case for remitter. We are dealing with the years of assessment 1992 to 2002 and the Determination was made 8 years ago and like Ribeiro PJ, I also "recoil from the idea of a remitter"[10]. More importantly, the Commissioner has not made out a case for remitter.

32. The main contest between the parties before the Board was over the characterization of the taxpayer's business. Then, it was the Commissioner's case that the activities of the local affiliates should be disregarded, because their activities were not part of the taxpayer's business, and did not generate any relevant profit.[11]

33. In fairness to counsel who appeared for the Commissioner before the Board, it is easy to understand why the Commissioner had not taken the para 38 argument (nor the reformulated argument) before the Board. When one compares the services to be provided under the standard agency agreement and the services which LFT's affiliates had undertaken to provide under the standard affiliates contract, it is obvious that they covered essentially the same matters. Given the injunction "to grasp the reality … focusing on effective causes …"[12], had either argument been raised before the Board, I believe the Board would have expressly decided it against the Commissioner.

34. The Commissioner's case before the Board was that LFT had agreed with a customer to perform certain operations for 6%, and is paying a 3rd party 4% (the overseas affiliates, eg Li & Fung (Korea) Ltd) to perform the overseas part of those operations. What was left to LFT, namely, 2%, related entirely to its trade of "supply-chain management" which it carried on through its senior "controlling minds" in Hong Kong. That profit was earned not through day to day handling of orders from customers (that had been sub-contracted to the affiliate companies) but through maintaining long-term commercial

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9 Such profits may be small, given the nature of the activities which was said to have taken place in Hong Kong, because on this argument the value to be attributed to the activities carried out by the affiliates would not be confined to the 4% payable to them. Compare the Commissioner's submission before the Board outlined in paras 34 and 35 below.

10 para 83 of *ING Baring*.

11 Similar submissions were repeated in the Commissioner's skeleton submissions dated 31 March 2011 for the hearing of the appeal before Reyes J on 6 April 2011, but as Reyes J noted "not pressed".

12 Per Bokhary PJ, see para 14 above.

relationships and monitoring the performance of the contracts the LFT had with its customers.

35. Mr Yu also relied on the fact that apportionment was an issue before the Board, but it is clear that there apportionment was sought on a different basis, as can be seen from the skeleton argument dated 13 January 2006 for the Commissioner:

> "10. Even if the overseas affiliates were acting as agents of the Appellant, and so were sub-agents of the customers, the Commissioner would still submit that for profits tax purposes, the operations of the overseas affiliates should be viewed separately from the operations of the Appellant. The overseas affiliate gets its share (4%) of the gross commission (7%) for its work overseas: what is left to the Appellant as profit relates entirely to what the Appellant itself does.
>
> ……
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> 29. Should the Board consider that apportionment is in point, the Commissioner submits that determining the appropriate apportionment is very simple, in that the Appellant has already done it for us. It has apportioned its profits between the onshore part of its operations and the offshore part of its operations by engaging the overseas affiliates to perform the offshore part for a commission (originally 4% of FOB, then 5% of costs). It has never been suggested by the Appellant that this is not a proper price for the overseas affiliates to pay; all that Edward Yim said (Day 8, pp 12 and 13) was that the original 4% arrangement sometimes caused cash flow problems for the affiliates, so they were changed to 'cost plus 5%', but the two calculations worked out 'more or less the same': see Edward Yim's answer to the Chairman's question, Day 8, p 33. Mr Yim confirmed that the overseas affiliates paid tax on its profits calculated only by reference to the commission received from the Appellant. The Commissioner submits that there is no need for any further apportionment."

36. Had the para 38 argument been run before the Board, it might have undermined the Commissioner's then more ambitious claim, which was for 2%[13] of the FOB value.

37. For completeness' sake, I turn to the skeleton submission for the Taxpayer dated 28 December 2005, prepared for the hearing before the Board, there a relevant issue was identified as:

> "9. iii) where do LFT's profits arise? Do they (as the IRD contends) arise wholly in Hong Kong or (as the tax payer submits) in Hong Kong

[13] See footnotes 1 and 2 above. The actual figure used before the Board was 3%, on the basis that LFT was paid 7% of the FOB value and paid its affiliates 4%.

(where the local office handling the order is in Hong Kong) and outside Hong Kong (where the local office handling the order is outside Hong Kong)?"

38. The Taxpayer's skeleton submission went on to say:

> "80. (1) The taxpayer does not accept that any services which produce profits are performed in Hong Kong where an order is being handled by a local office outside Hong Kong; and it asserts that, in such a case, all the relevant services are performed outside Hong Kong and that whatever (if anything) is done in Hong Kong is preparatory, antecedent, incidental or ancillary to the earning, and not an effective cause, of the profits."

39. There were also in paras 10 - 65 submissions on the facts to support the taxpayer's case, which underlined the important distinction between LFT managing its business in Hong Kong and its source of profits by its affiliates outside Hong Kong. The Taxpayer's case compares well with this description of ING Baring's activities by Ribeiro PJ:

> "50. Such an approach fails to focus on the transactions which proximately produce the profits and emphasises antecedent or incidental matters that, while commercially essential, are legally irrelevant. However impressive the client may find the Taxpayer's research and sales service, in the absence of trades successfully executed abroad, no brokerage income arises. But quite apart from that objection in principle, the Board's suggestion is at odds with the evidence. Thus, the evidence was that '... approximately two thirds of the Asian Agency Brokerage business of the Group was generated by sales effort in the London and New York offices.' Moreover, the Board found that the research 'was undertaken by analysts based in each market' with the research publications then being 'distributed to clients and ... used primarily by sales desks as reference and selling material stock.' If two-thirds of the Group's Asian agency business was generated by sales activities in London and New York using research generated by analysts working in the foreign markets in which the trades were effected, it is very hard to see how focusing on these as 'factors' could lead to the conclusion that profits generated by those activities were sourced in Hong Kong."

40. I have gone into some detail over the way in which the matter was argued before the Board because I believe Mr Yu's complaint that the Board had failed to deal with the para 38 argument is unfair. The Board could not be blamed for not dealing with a point which was not raised before them.

41. In his submission before us, Mr Yu focused on paras 84 – 86 of the decision, and submitted that they were conclusionary findings of the Board and that they had given no

reasons. He also complained that although the hearing had concluded on 19 January 2006, the decision was not handed down until 12 June 2009, a regrettable fact which the learned judge has remarked upon in his judgment.

42. Given such delay, obviously we should scrutinize the Board's findings of fact and the reasons for their conclusions with particular care in order to see whether the decision contained errors probably or possibly, attributable to the delay sufficient to satisfy us that it would be unsafe and unfair to allow it to stand: *Cobham v Frett* [2001] 1 WLR 1775.

43. However, as Mr Goldberg has explained, the Board had had the benefit of the transcript of the proceedings and carefully prepared submissions with cross-references to the transcript. The factual evidence consisted of oral testimony (LFT called 34 witnesses) as well as written statements. Their evidence have been summarized with great care in pages 37-62 of the decision, followed by a careful consideration of the expert evidence which occupied pages 62-76 with citations from the transcript of their evidence.

44. Mr Yu commented on the fact that the Board had summarized the evidence of the factual witnesses without stating which part of their evidence it had accepted. But it is obvious that the bulk of such evidence (relating to the source of income issue) was uncontentious. Indeed, para 29 of the Decision states:

> "Mr. Milne told us that 'there should not be too much scope for disagreement about the primary facts' and that CIR was not so concerned about what happened at the bottom but was more concerned about what happened at the top."[14]

45. But when the Board dealt with evidence which was potentially controversial, such as the expert evidence, it dealt with such evidence critically. There is no substance in the complaint that the Board had merely summarized the evidence of the factual witnesses. Nor do I agree that the Board has not given sufficient reasons.

46. The Decision also contained a careful consideration of the authorities on "source of profits" (pages 94 to 102). The learned chairman traced the authorities from *CIR v Hang Seng Bank Ltd* [1991] 1 AC 306 to *ING Baring*, the judgment of which was delivered about 1½ year after the conclusion of the hearing before the Board. Mr Yu complained that although the Board had referred to and relied on *ING Baring*, the parties were not given an opportunity to address the Board on that decision. *ING Baring* provided important elucidation on the application of settled principles, and which the Board would have been remiss to ignore. The Commissioner, if he thought it advisable to do so, could have requested an opportunity to address the Board on *ING Baring*. Furthermore, I do not understand Mr Yu to say that the Board had misunderstood *ING Baring*[15].

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[14] That is because, according to the Commissioner, LFT's profits were not derived from the activities of its local affiliates but from its management role which took place in Hong Kong.

[15] Although he suggested that the Board had misapplied it.

47. Mr Goldberg emphasised that the question before us is:

> "Whether, on the facts found by the Board, the true and only reasonable conclusion contradicts the Board's conclusion …"

48. Mr Goldberg submitted and I agree:

> "1.2 The Board, in the Decision, considered the arguments of the Respondent, the CIR, applied the correct principles and, on the basis of the Evidence before it, made the Fundamental Finding:
>
> > '… as a fact that all the profit producing/making activities/transactions took place outside Hong Kong'.
>
> By the Conclusion, the Board held:
>
> > 'that the disputed profits were all sourced outside Hong Kong. Thus, no question of apportionment arises.'"

49. Mr Goldberg also submitted that in para 84, the Board made findings of facts and they found that where orders were handled by an agent, everything which, factually LFT did and had to do to earn profits, was done outside Hong Kong. I agree.

50. It is perhaps revealing that Mr Yu commenced his submission by referring us to the decision of Barnett J in *Commissioner of Inland Revenue v Inland Revenue Board of Review and Anor* [1989] 2 HKLR 40 where Barnett J said at page 47:

> "… that once the Court is seized of a case stated, it must, subject to any necessary adjournment, deal with any point of law arising out of the case stated."

51. Mr Yu also relies on the judgment of Yuen J (as she then was) in *Commissioner of Inland Revenue v Quitsubdue Ltd* [1999] 2 HKLRD 481 at 485, where she said the court might:

> "… determine a question of law which it considered arose from the Case Stated, even if it were not contained in it."

52. With respect, I do not believe these observations assist Mr Yu. I have stated earlier that the Board could not be faulted for not dealing with the para 38 argument, which was not raised before it. I can see no basis to remit the matter to the Board so that the Commissioner could then advance a new case on apportionment.

53. Mr Yu submitted that although the question asked:

"Whether, on the facts found by the Board …" (my emphasis),

further facts have been agreed, 2 of which he submitted, are important. These facts are:

"6. In an interview reported in the Harvard Business Review dated 1 September 1998, Mr Victor Fung said:

'The company is managed on a day-to-day basis by the product group managers. Along with the top management, they form what we call the policy committee, which consists of about 30 people. We meet once every five to six weeks. People fly in from around the region to discuss and agree on policies. Consider, for example, the topic of compliance, or ethical sourcing. Compliance is a very hot topic today - as well it should be. Because our inspectors are in and out of the factories all the time, we probably have a better window on the problem than most companies. If we find factories that don't comply, we won't work with them. However, because there is so much subcontracting, you can't assume that everyone is doing the right thing. That is, you have to make sure that a supplier that was operating properly last month is still doing so this month. The committee of 30 not only shapes our policies but also translates them into operating procedures we think will be effective in the field. And then they become a vehicle for implementing what we've agreed on when they return to their divisions.'

……

9. In an interview reported in the Harvard Business Review dated 1 September 1998, Mr Victor Fung said:

'Consider our Gymboree division, one of our largest. The division manager, Ada Liu, and her headquarters team have their own separate office space within the Li & Fung building in Hong Kong. When you walk through their door, every one of the 40 or so people you see is focused solely on meeting Gymboree's needs. On every desk is a computer with direct software links to Gymboree. The staff is organized into specialized teams in such areas as technical support, merchandising, raw material purchasing, quality assurance, and shipping. And Ada has dedicated sourcing teams in our branch offices in China, the Philippines, and Indonesia because Gymboree buys in volume from all those countries. In maybe 5 of our 26 countries, she has her own team, people she hired herself. When she wants to sources from, say, India, the branch office helps her get the job done.'"

54. To put Mr Yu's submission in context, it is necessary to go back in time. The case stated is dated 19 March 2010, and the hearing of the appeal was fixed to commence before Reyes J on 6 April 2011 with four days reserved.

55. By summons stated 15 July 2010, the Commissioner applied, under section 69(4) of the Inland Revenue Ordinance, Cap. 112, to have

> "1. the case stated remitted to the Board;
>
> 2. by way of amendment or edition to the case stated the Board do:
>
> (1) set out the evidence in Part I of the Schedule;
>
> (2) pose the additional questions set out in Part II of the Schedules;"

56. On 11 February 2011, by summons of that date, the Commissioner asked for leave to amend the summons of 15 July 2010. The amendment asked that the Board:

> "3. make findings of primary facts relating to the issues raised by the additional questions set out in the Part II of the Schedule."

57. Part II of the Schedule raised four questions. The 1st and 2nd questions related to source of income. The summons of 11 February 2011 sought to amend in part – the first of these two questions. I will not go into the new questions which were sought to be raised, suffice to note that these questions did not include the reformulated argument or the para 36 argument, and it does not appear that the summons of 11 February 2011 and what followed were made in aid of the reformulated argument or para 36 argument.

58. At the hearing on 17 February 2011, Reyes J gave leave to amend the summons but he struck out the 1st and 2nd questions. The learned judge also suggested that the parties should try to come up with a list of agreed facts, so that it would not be necessary to ask the Board to make additional findings.

59. By 15 March 2011, the parties had agreed a total of 12 facts[16]. However, some facts which the Commissioner wished to be agreed were not agreed. As a result, the Commissioner restored the summons for hearing before Reyes J on 28 March 2011. The Commissioner then sought a remittal to the Board for a finding of fact that:

> "The contents quoted in paras. 6 and 9 of the agreed facts of what Victor Fung said to the *Harvard Business Review* are facts."

60. On 28 March 2011, Reyes J dismissed the amended summary. According to the transcript, the learned judge said:

[16] Including facts paras 6 and 9 referred to in para 53 above.

> "COURT: Fine. I think it is far too late for me to remit anything back to the Board. It was incumbent on the Commissioner to get her act together at a much earlier stage if there were going to be any facts to be – or any questions of fact to be remitted to the Board to make further findings.
>
> It seems to me that this is very last minute, and I simply cannot allow it at this stage, and therefore the application is dismissed."

61. There was then an application for leave to appeal against Reyes J's decision of 28 March 2011 which was heard by this court (Tang Ag CJHC and A Cheung J (as he then was)) on 1 April 2011. The court refused leave to appeal[17].

62. I mention these proceedings to underline the fact that paras 6 and 9 of the agreed facts cannot help the Commissioner since although what Mr Victor Fung was reported to have said in *Harvard Business Review* was agreed, the contents were not agreed.

63. Furthermore, Mr Yu's reliance on the *Harvard Business Review* reports was to show that some of the clause 3 activities were performed in Hong Kong. But since the point had not been taken before the Board it would not be right to remit the matter to the Board to enable the Commissioner to raise this new point which most probably will require further evidence.

64. For the above reasons, I dismiss the Commissioner's appeal with an order *nisi* that the Commissioner pays the costs of the appeal.

Hon Hartmann JA:

65. I agree fully with the judgment of the Vice President.

Hon Chu JA:

66. I agree with the reasons given by the Vice President and the orders that he proposes.

(Robert Tang)	(M J Hartmann)	(Carlye Chu)
Vice-President	Justice of Appeal	Justice of Appeal

[17] See reasons for judgment in HCMP 541/2011 dated 20 April 2011.

Mr. Benjamin Yu, SC and Mr. Eugene Fung instructed by Department of Justice for the Commissioner of Inland Revenue

Mr. David Goldberg, QC and Mr. Stewart K. M. Wong, SC instructed by Clifford Chance for the Respondent