1997, Inland Revenue Appeal No. 2

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE

Between

EMERSON RADIO CORPORATION Appellant

- and -

THE COMMISSIONER OF INLAND REVENUE Respondent

JUDGMENT

Coram: Mr Recorder Ribeiro SC

Dates of hearing: 24th and 25th June 1998

Date of handing down Judgment: 30th June 1998

This Appeal

This is an Appeal by way of case stated brought under section 69 of the Inland Revenue Ordinance ("the Ordinance") against a decision of the Board of Review ("the Board") given on 10th July 1996. The taxpayer in question is a New Jersey corporation named Emerson Radio Corporation ("the Taxpayer") and the Appeal is brought on its behalf by its wholly owned Hong Kong subsidiary, Emerson Radio (Hong Kong) Limited ("the Hong Kong Company").

The Appeal is against the Board's dismissal of the Taxpayer's appeal from a refusal by the Commissioner of Inland Revenue ("the Commissioner") to correct certain profits tax assessments raised against the Taxpayer. Those assessments were made on the basis that certain royalty payments received by the Taxpayer from the Hong Kong

Company fell within the deeming provisions of section 15(1)(b) of the Ordinance and so were chargeable to profits tax.

Section 15(1)(b), so far as material, states as follows:-

> "(1) For the purposes of this Ordinance, the sums described in the following paragraphs shall be deemed to be receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong-
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> ....
>
> (b) sums, not otherwise chargeable to tax under this Part, received by or accrued to a person for the use of or right to use in Hong Kong a patent, design, trademark, copyright material or secret process or formula or other property of a similar nature, ... "

The phrase "arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong" is a reference to conditions for the charge to profits tax laid down by section 14(1) of the Ordinance. Section 15(1)(b) deems such conditions satisfied in respect of receipts or accruals falling within its provisions.

In dismissing the Taxpayer's appeal and confirming the Commissioner's Determination, the Board decided that the whole of the royalties received by the Taxpayer were caught by section 15(1)(b) and so were chargeable to profits tax which would be computed in accordance with section 21A of the Ordinance.

The Board's findings of fact

In reaching this conclusion, the Board made the findings of fact set out in paragraphs 4 and 5 of the Case Stated which are reproduced below. While the Case Stated expressly indicates that paragraph 4 contains the primary facts found by the Board, it is common ground that the matters set out in paragraph 5 also represent such findings of fact.

> *"4. The primary facts found by the Board are as follows:*
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> *(i) At all relevant times, the Taxpayer was a US incorporated company. It was the owner in America, Hong Kong and elsewhere of valuable trademarks which comprised the name of the Taxpayer. The trademarks were used in respect of electrical and electronic products sold primarily to customers in America but also worldwide.*
>
> *(ii) Emerson Radio (Hong Kong) Limited (the "Hong Kong Company") was a private company incorporated in Hong Kong which at all relevant times was a wholly owned subsidiary of the Taxpayer.*

(iii) There was a close relationship between the Taxpayer and the Hong Kong Company. The Hong Kong Company caused goods to be made by third parties in Hong Kong, China, Malaysia, Thailand, Taiwan, Japan and South Korea bearing the name of the Taxpayer. These goods, which were manufactured on the instructions of and for the Hong Kong Company, were purchased by the Hong Kong Company from the manufacturers and sold by the Hong Kong Company to department stores and others, primarily in the United States but also elsewhere. The Hong Kong Company did not sell any goods to customers in Hong Kong. The goods were then sold by the customers of the Hong Kong Company to end users.

(iv) The Hong Kong Company had an agreement with the Taxpayer pursuant to which the Taxpayer would provide a number of services to the Hong Kong Company. The services included design of products, after sales service, the promotion of the brand name, and either assisting in or finding customers for the goods sold by the Hong Kong Company. For all of these services the Hong Kong Company had an agreement with the Taxpayer under which it paid service charges. The service charges are not the subject matter of this appeal.

(v) On 1 April 1984, the Taxpayer and the Hong Kong Company entered into a royalty agreement (the "1984 Royalty Agreement") pursuant to which the Taxpayer granted to the Hong Kong Company the right to use the name of the Taxpayer in return for the payment of a royalty. The relevant sections of the 1984 Royalty Agreement read as follows:-

> *"(The Taxpayer) holds the right for the use of the trademark, "Emerson" for electronic home entertainment products sold in the United States of America (US). (The Hong Kong Company) wishes to continue to sell "Emerson" brand products to customers with locations in the US."*
>
> *"(The Hong Kong Company) agrees to pay (the Taxpayer) for the use of the "Emerson" trademark on products it sells to its US customers. The fee to be paid will be 1 percent of the sales price of the products sold to the US customers of (the Hong Kong Company). If during any fiscal year ending March 31, sales by (the Hong Kong Company) to US customers exceed \$50,000,000, the fee on the excess sales will be ½ percent of the sales price of products sold in excess of \$50,000,000. Payment of the royalty fees will be due within thirty days after the end of each month."*

A copy of the 1984 Royalty Agreement is attached as Appendix A to this case stated.

(vi) By virtue of an agreement dated 1 April 1987, the Taxpayer and the Hong Kong Company entered into a new royalty agreement (the "1987 Royalty Agreement") on similar terms to the 1984 Royalty Agreement, except that the rates

of royalty payable were revised upwards from 1 percent to 1.8 percent and ½ percent to 1 percent respectively.

A copy of the 1987 Royalty Agreement is attached as Appendix B to this case stated.

(vii) By a letter dated 11 July 1991, the Taxpayer wrote to the Hong Kong Company and placed on record that it had been agreed that the rates of royalty payable should be further increased to 2% of all US sales for all fiscal periods beginning with 1 April 1987. The reason given for this increase was because "the value of the Emerson name in the US and the maintenance of that name in the US had seen a substantial cost increase since the last amendment. This is due primarily to the increased costs of national and co-op advertising during this period and extension of the trade mark to such products as telephones, fax machines and computers which require additional state side efforts on our part." Although reference was made to this second upward revision taking effect from 1 April 1987, it appears that in fact the second upward adjustment of royalty payments may have taken place in the financial year ended 31 December 1991.

A copy of the 11 July 1991 letter agreement is attached as Appendix C to this case stated.

(viii) At all relevant times, the Hong Kong Company carried on business in Hong Kong and paid profits tax on all of its profits on the basis that all of its profits were sourced in Hong Kong.

(ix) The Hong Kong Company (as agent for the Taxpayer) filed profits tax returns during the relevant period with respect to all royalties received by the Taxpayer from the Hong Kong Company. The royalties were disclosed in returns filed with respect to the years of assessment 1985/86 to 1989/90. With respect to the years of assessment 1990/91 and 1991/92, profits tax returns were filed that disclosed only royalties paid with respect to goods which had been manufactured in Hong Kong.

(x) The following profits tax assessments were raised in respect of the royalty payments:

> *27 November 1986 A Notice of Assessment and Demand for Profits Tax for 1985/86 was issued in the name of the Hong Kong Company (as agent for the Taxpayer), showing assessable profits of $810,846 and tax payable thereon of $150,006. The tax was paid as assessed.*
>
> *15 December 1987 A Notice of Assessment and Demand for Profits Tax for 1986/87 was issued in the name of the Hong Kong Company (as agent*

for the Taxpayer), showing assessable profits of $1,477,544 and tax payable thereon of $273,345. The tax was paid as assessed.

14 November 1988 A Notice of Assessment and Demand for Profits Tax for 1987/88 was issued in the name of the Hong Kong Company (as agent for the Taxpayer), showing assessable profits of $2,448,745 and tax payable thereon of $440,774. The tax was paid as assessed.

8 December 1989 A Notice of Assessment and Demand for Profits Tax for 1988/89 was issued in the name of the Hong Kong Company (as agent for the Taxpayer), showing assessable profits of $3,170,328 and tax payable thereon of $538,955. The tax was paid as assessed.

20 November 1990 A Notice of Assessment and Demand for Profits Tax for 1989/90 was issued in the name of the Hong Kong Company (as agent for the Taxpayer), showing assessable profits of $12,233,861 and tax payable thereon of $2,018,587. The tax was paid as assessed.

(xi) On 25 September 1991, the Hong Kong Company applied through its tax representative at that time, (the "First Tax Representative"), to correct the profits tax assessments for 1985/86 to 1989/90, pursuant to section 70A of the Inland Revenue Ordinance ("IRO"). The First Representative argued that the royalties income was not derived from Hong Kong and should not be chargeable to Hong Kong profits tax, because some of the products were manufactured offshore.

(xii) In a letter dated 7 July 1992 from the First Tax Representative to the Assessor, the First Tax Representative stated that the royalty charges and the terms of the royalty agreements were determined by the Taxpayer and that no negotiation of the agreement ever took place in Hong Kong.

(xiii) By a letter dated 21 April 1993, the Assessor refused the Hong Kong Company's application under section 70A of the IRO.

(xiv) By a letter dated 20 May 1993, the Hong Kong Company, acting through the First Tax Representative, objected to the Assessor's notice of refusal on the basis that the source of royalty income was the sale of products in the US and that the place where such products were manufactured was irrelevant.

(xv) On 9 November 1993, the Assessor issued a Notice of Assessment and Demand for Profits Tax for 1991/92 in the name of the Hong Kong Company (as agent for the Taxpayer), showing assessable profits of $7,574,174 and tax payable thereon of $1,249,738.

(xvi) On 12 November 1993, the Assessor issued a Notice of Assessment and Demand for Profits Tax for 1990/91 in the name of the Hong Kong Company (as

agent for the Taxpayer), showing assessable profits of $5,666,709 and tax payable thereon of $935,006.

(xvii) On 30 November 1993, the Hong Kong Company, acting through the First Tax Representative, objected to the profits tax assessment for 1991/92.

(xviii) On 1 December 1993, the Hong Kong Company, acting through the First Tax Representative, objected to the profits tax assessment for 1990/91.

(xix) On 14 February 1994 the Hong Kong Company appointed a new tax representative (the "Second Tax Representative").

(xx) On 16 February 1994, the Hong Kong Company, acting through the Second Tax Representative requested the Commissioner to reconsider the profits tax assessments for 1985/86 to 1991/92 on the basis that:

a. the royalty income which accrued to the Taxpayer fell outside the ambit of section 15(1)(b) of the IRO since the Hong Kong Company did not sell the products carrying the "Emerson" trade mark in Hong Kong and, therefore, did not use the trade mark in Hong Kong; and

b. the Hong Kong Company had previously misinterpreted the phrase "use in Hong Kong" in section 15(1)(b) of the IRO by equating the same with "use in connection with a business carried on in Hong Kong".

(xxi) On 13 February 1995, the Commissioner issued a determination on all three objections filed by the Hong Kong Company upholding the Assessor's refusal to correct the 1985/86 to 1989/90 profits tax assessments under section 70A of the IRO and confirming the profits tax assessments for the years of assessment 1990/91 and 1991/92 against which the Hong Kong Company had objected.

(xxii) On 9 March 1995, the Second Tax Representative filed a notice of appeal with the Clerk to the Board of Review to appeal against the Commissioner's determination on (a) the assessor's notice of refusal to correct the profits tax assessments with respect to the years of assessment from 1985/86 to 1989/90 and (b) the profits tax assessments with respect to the years of assessment of 1990/91 to 1991/92.

5. Two witnesses who were executives of the Hong Kong Company gave evidence on behalf of the Taxpayer before the Board of Review. The first witness, Miss Teresa Tsui said she was familiar with the general operations of the Hong Kong Company except for financial matters. She explained how the Hong Kong Company operated. The second witness, Mr. Kazuo Furusho, the General Manager of the Quality Control and Engineering Department of the Hong Kong Company, gave evidence as to how the Hong Kong Company designed its products *and had the products manufactured. The evidence of the two witnesses was accepted by the Board of Review. The relevant evidence was:*

> *(i) The Hong Kong Company sold products only to customers who were outside Hong Kong. It had no Hong Kong customers.*
>
> *(ii) Products were manufactured both outside Hong Kong and inside Hong Kong.*
>
> *(iii) Those products that were manufactured outside Hong Kong never entered Hong Kong (except for trans-shipment of goods produced in Malaysia and, latterly, in the PRC). Products were shipped directly from manufacturers to customers.*
>
> *(iv) No selling activities were conducted in Hong Kong, i.e. no negotiations with customers. No sales staff were employed by the Hong Kong Company. Selling activities were conducted and co-ordinated by the Taxpayer in the United States. Customers dealt with the Taxpayer and forwarded their purchase orders to the Taxpayer.*
>
> *(v) The Hong Kong Company paid certain fees to the Taxpayer for the services that were provided by the Taxpayer.*
>
> *(vi) The goods were not advertised in Hong Kong.*
>
> *(vii) The Hong Kong Company's activities in Hong Kong were limited to handling paperwork; receiving purchase orders from the Taxpayer; issuing purchase orders to manufacturers; arranging and handling letter of credit facilities; co-ordinating shipments of goods; and liaising with manufacturers concerning production of goods.*
>
> *(viii) Liaison with manufacturers outside of Hong Kong was conducted through liaison offices of the Hong Kong Company (Thailand) or the Taxpayer (Japan, Taiwan, Korea).*
>
> *(ix) The "Emerson" trademark existed in many countries, including the countries where the goods were manufactured (Taiwan, Japan, Malaysia, Thailand, Hong Kong) and in countries where goods were sold (USA).*
>
> *(x) The "Emerson" trademark was physically applied to the products by the manufacturers.*
>
> *(xi) Products were designed outside of Hong Kong by the Taxpayer and unrelated designers. No designs were produced in Hong Kong.*

> (xii) *Manufacturing moulds were produced in the countries where the relevant goods were manufactured (with one exception).*

The Board's decision

The Board held that the meaning of section 15(1)(b) was clear and unambiguous. They held that because of the words "use in Hong Kong", it had a territorial connotation (although they added that this was not necessarily the same as for the phrase "arising in or derived from Hong Kong" in the main charging section). The Board considered that "use" was to be given its ordinary meaning and was not a technical term, so that it was inappropriate to import into the construction of section 15(1)(b), the technical meaning attributed to that word for trademark law purposes. The Board however added that the trademark law approach should not be ignored nor that one should seek to give the word "use" a different meaning.

On the basis of the abovementioned royalty agreements (compendiously referred to here as "the Royalty Agreement") the Board found that the Hong Kong Company agreed to pay its parent "for the use of the Emerson trademark on products it sells to its US customers", that this was the right granted by the Taxpayer to the Hong Kong Company and that "it was for that right that the royalty was paid".

Having noted that for the purposes of trademark law, "the application of the trademark to the goods themselves and to packing materials and other paper articles by the manufacturers of the goods would no doubt constitute use" and that a whole range of persons may have "used" the trademark in a variety of ways, the Board decided that these aspects of trademark law did not help in the construction of section 15(1)(b). The Board went on to conclude as follows:-

> *"In our opinion there can be no doubt whatsoever that the Hong Kong Company did use the trademark. Indeed this is common ground by both parties. The only question in dispute between the parties is where the use took place and whether or not the royalty payments were all attributable to use in Hong Kong. We find that the Hong Kong Company did use the trademark, did use the trademark in Hong Kong, and that all of the royalty payments made in respect of the use of the trademark were royalty payments made in respect of the use of the mark in Hong Kong for the purposes of section 15(1)(b) of the Inland Revenue Ordinance." [§11(vi)]*

> "...... *Use is a simple word having a simple but very wide meaning. Applying it to the facts now before us we have no doubt that the trademark was used in Hong Kong, was used in all of the countries where the goods were made, and was used in all of the countries where the goods were ultimately sold and which we were told was primarily USA. ....." [§11(viii)]*

The Board also rejected any proposed apportionment of the Taxpayer's receipts to confine the charge to profits tax to royalties paid in respect of goods manufactured in Hong Kong, stating as follows:-

> *"As we have said earlier the royalty was paid by the Hong Kong Company to the Taxpayer for the use by the Hong Kong Company of the trademark in relation to goods which the Hong Kong Company sold to its US customers. The Hong Kong Company carried on its business in Hong Kong. It paid tax on all of the profits which it made and these were made in Hong Kong. This is common ground between the parties. Without the licence from its parent the Hong Kong Company could not have carried on its business in Hong Kong. We were asked by the solicitor for the Hong Kong Company to consider apportionment of the royalty if we considered that there was a use of the mark in Hong Kong. We find it inappropriate to consider any such apportionment. The royalty payment was one indivisible sum paid by the Hong Kong Company for using the mark. No doubt the parties to the licence agreement could have worded that agreement differently, but what we have to consider is the agreement as it appears before us. The Hong Kong Company paid one indivisible royalty to its parent for the use of the mark. It carried on its business in Hong Kong and that is where it used the trademark for the purposes of the Inland Revenue Ordinance." [§11(ix)]*

It was on this basis that the Board dismissed the appeal and confirmed the Commissioner's Determination.

Questions of law for opinion of the Court

The questions of law formulated for the opinion of this Court on this Appeal are as follows:-

1. Whether the true and only reasonable conclusion that can be drawn from the primary facts found and evidence accepted by the Board is that the Hong Kong Company did not use the trademark in Hong Kong?

2. Whether, if the trademark was used in Hong Kong, the true and only reasonable conclusion that can be drawn from the primary facts found and evidence accepted by the Board is that the royalty payments were not made for the use in Hong Kong of the trademark?

3. Whether, on the facts found by the Board, the Board erred in law in holding that:

   (i) the Hong Kong Company used the trademarks in Hong Kong for the purposes of section 15(1)(b) of the Inland Revenue Ordinance; and/or

(ii) all of the royalty payments made in respect of the use of the trademarks were royalty payments made in respect of the use of the trademarks in Hong Kong for the purposes of section 15(1)(b) of the Inland Revenue Ordinance?

4. In the alternative, whether, on the facts found by the Board, the Board erred in law in refusing to apportion the royalty payments between payments for use of the trademark in Hong Kong and payments for the use of the trademark outside Hong Kong as the Board held that the royalty payment was one indivisible sum?

The parties' positions on this Appeal

The Taxpayer's primary case is that on the true construction of section 15(1)(b), royalties paid to it by the Hong Kong Company are only to be regarded as sums it has received "for the use of in Hong Kong .... a trademark" where the use in question involves sale in the market of goods bearing such trademark. The Taxpayer contends that there was no such use of the trademark in Hong Kong and/or that no sums received by it were received for such use in Hong Kong. The Taxpayer therefore contends that, contrary to the decisions of the Commissioner and the Board, the whole of the royalties received from the Hong Kong Company fall outside section 15(1)(b) and outside the charge to profits tax.

The Taxpayer's fall-back position is that if "use of a trademark" has a meaning extending beyond the restrictive meaning contended for, and if there was in fact relevant "use" of its trademark in Hong Kong, the Court should order an apportionment to segregate the chargeable royalties deriving from such Hong Kong use from other, non-chargeable, royalties.

The Commissioner's primary case is that the Board's findings establish relevant "use" of the "Emerson" trademark in Hong Kong in a variety of ways and that all of the royalties received by the Taxpayer are attributable to such use, bringing all such royalties within the section 15(1)(b) and so within the charge to profits tax.

The Commissioner, like the Taxpayer, also adopts apportionment as his fall-back position.

One issue canvassed before the Board, concerning the requirements of section 70A of the Ordinance, has not been pursued on this Appeal.

Application by the Commissioner for an additional question to be answered

At the hearing, Mr Fok, who appeared on behalf of the Commissioner, indicated that he wished to raise for determination by this Court a question of law additional to the questions formulated in the Case Stated set out above. He formulated the proposed additional question as follows:-

> "Whether on the facts found by the Board, the Board could have held in law that the Hong Kong Company paid the Taxpayer for the right to use the trademarks in Hong Kong for the purposes of section 15(1)(b)."

Mr Barlow, who appeared for the Taxpayer, objected on the ground that it was not open to the Commissioner to seek the Court's opinion on questions not framed in the Case Stated.

I indicated that I would rule on Mr Fok's application in the course of giving judgment. This I now do.

The Appeal from the Board to the Court of First Instance is governed by section 69 of the Ordinance. The relevant provisions state as follows:-

> "(1) The decision of the Board shall be final:
>
> Provided that either the appellant or the Commissioner may make an application requiring the Board to state a case on a question of law for the opinion of the [Court of First Instance] .....
>
> (2) The stated case shall set forth the facts and the decision of the Board, and the party requiring it shall transmit the case, when stated and signed, to the [Court of First Instance] within 14 days after receiving the same.
>
> (3) .....
>
> (4) Any judge of the [Court of First Instance] may cause a stated case to be sent back for amendment and thereupon the case shall be amended accordingly.
>
> (5) Any judge of the [Court of First Instance] shall hear and determine any question of law arising on the stated case and may in accordance with the decision of the court upon such question confirm, reduce, increase or annul the assessment determined by the Board, or may remit the case to the Board with the opinion of the court thereon. Where a case is so remitted by the court, the Board shall revise the assessment as the opinion of the court may require."

If the matter were free from authority, it would have been my view, based simply on the wording of section 69, that Mr Barlow was right and that questions additional to those framed in the stated case could not be added in the course of the hearing itself.

It is true that section 69(2) stipulates only that the facts and the decision must be in the stated case and makes no mention of any questions framed for the opinion of the Court. However, since the whole purpose of stating the case is, as laid down in section 69(1), to seek the opinion of the Court on a point of law, I would have thought that questions formulated for that purpose were an integral part of the Case Stated.

If this were so, I would have construed the requirement of section 69(5) that the Court "shall hear and determine any question of law arising on the stated case" to mean *arising from the stated case comprising the facts, decision and questions formulated.* Plainly, all sorts of questions of law (e.g., as to the true construction of documents, as to legal relationships amongst the individuals and entities concerned in the Taxpayer's business, etc.) may have to be determined in answering the questions framed. Moreover, the provisions of section 69(4) appear to support this approach. That sub-section provides an avenue for amending the stated case to enable additional questions to be added if necessary. The Court therefore need never stray outside the four corners of the stated case when dealing with the appeal.

There is in fact some authority to support the above approach. In *Attorney General v Leung Chi-kin* [1974] HKLR 269, Huggins J, delivering the decision of the Full Court, provided guidelines as to the operation of the case stated procedure on appeals from a magistrate, stating inter alia as follows:-

> "The basic requirements of a case stated are that it should be complete in itself and should not have any annexure unless it is essential to the decision of the appeal that such annexure should be before the court. .... The case stated should contain in numbered paragraphs
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> (a) the material findings of fact or, where appropriate, a statement that no finding was made upon an issue which is alleged to be material .....;
>
> (b) the contentions of law of each party upon each of the issues referred for the opinion of the court;
>
> (c) a statement of the decision of the magistrate on those issues .....;
>
> (d) the questions the court is asked to answer. They should be stated clearly and concisely and care should be taken to ensure that the questions are not wider than is warranted by the facts. *A case stated is not to be used as a device for obtaining the opinion of the court upon questions which did not form the basis of the magistrate's decision, and, even where a point did form part of the basis of his decision, if it was not taken at the trial the court will now allow it to be argued on appeal unless it is one which no evidence could alter*: Kates v. Jeffery [1914] 3 KB 160." (Italics supplied)

Although this was a judgment concerned with magistrates' appeals, Barnett J in *Commissioner of Inland Revenue v Inland Revenue Board of Review* [1989] 2 HKLR 40 at 49G suggested that its guidelines should be followed if possible in revenue cases. In that case, Barnett J himself stressed the importance of the questions framed in the stated case, holding (at p 50F-G) that he was "...... not prepared to accept that an applicant for a case stated may rely on a question of law which is imprecise or ambiguous and which gives the Board no clear idea of what material must be marshalled in their case."

However, despite such comments, Barnett J (at p 47G) acknowledged that he was bound by the Full Court's decision in *CIR v Rico Internationale Ltd* (1965) HKTC 229, which, in my view, clearly reached a conclusion contrary to that arrived at in *Attorney General v Leung Chi-kin*, with the Full Court in the *Rico* case holding that considerations governing magistrates' appeals differ from those applicable to tax appeals under section 69 of the Ordinance.

In the *Rico* case, the effect of section 69 was dealt with by Blair-Kerr, J as part of the ratio decidendi of his decision. Scholes, J expressed similar views, but considered his own remarks obiter dicta. Macfee J, who was the third member of the Court, did not mention the point.

The case stated in the *Rico* case framed the questions for the Court in extremely broad and uninformative terms, essentially asking merely "whether the Board was right in its decision" (at pp 236-7 and 264). At the hearing of the appeal in the Full Court, objection was taken to the raising of new points of law not expressly raised in the case stated (see pp. 266 and 268), but that objection failed. Blair-Kerr J, having held that similar United Kingdom legislation was to the same effect, continued as follows (at p 269):-

> "..... in both the English and Hong Kong enactments the case stated must include the facts and the determination; but not necessarily agreed points of law. The effect of the decisions appears to be summarised in *Simon's Income Tax (2^{nd} Ed)*, Vol 1 at p 280, where the learned author says:-
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>> 'The Court will give effect to any point of law arising on the facts stated in the case; but when it is sought to raise a question which was not raised before the tribunal below and this depends upon further evidence being taken, the Court will refuse to give effect to the point so sought to be raised.'
>
> Of course, while it may be legally unobjectionable for the Board to frame one question in terms sufficiently general to include any question of law which could arise on the facts and on their determination, it is also desirable that whenever possible they should be asked to say on what particular questions of law the opinion of the judge is being sought. However, section 69(5) is in the same terms as the corresponding English provision; and it would appear that the judge not only may, but is under a duty to, hear and determine 'any question of law arising on the case stated' (which need only include the facts and the determination) provided, of course, it is open to counsel, to argue the point on the facts as found. The

> position in tax appeals appears to be different from that which obtains in appeals under section 103 of the Magistrates Ordinance.
>
> In my view, the fact that the Board were not asked to, and did not, include the specific questions of law raised before this court and before the learned judge, is not fatal to this appeal."

Scholes, J stated obiter (at p 255): "..... in my opinion this court may consider newly raised points of law". In support, he cited *Attorney General v Avelino and Co* [1925] 1 KB 86 at 108-9, in which Atkin LJ stated:-

> "As I read the statutory procedure, which at that time depended on s. 59 of the Taxes Management Act, 1880, the Court is not limited to particular questions raised by the Commissioners in the form of questions on the case. All that the section provides is that if the appellant is dissatisfied with the determination as being erroneous in point of law he may require the Commissioners to state and sign a case, and the case shall set forth the facts and the determination, and upon that being done the Court has to decide whether or not the determination was or was not erroneous in point of law, and any point of law that can be raised properly upon the facts found by the Commissioners the Court can decide. No doubt there may be a point of law in respect of which the facts have not been sufficiently found, and if that point of law was not raised below at all and cannot be raised without further facts on either side, the Court may very well refuse to give effect to it, and either party may have precluded themselves by their conduct from raising in the Court of Appeal the point of law which they deliberately refrained from raising down below. Those questions, of course, have to be considered. But apart from that, if the point of law or the erroneous nature of the determination of the point of law is apparent upon the case as stated, and there are no further facts to be found, the Court can give effect to the law."

In the light of the *Rico* case, Barnett J in *Commissioner of Inland Revenue v Inland Revenue Board of Review* stated:-

> "I accept, and indeed I am bound by that authority, 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." (at p 47G-H)

In the light of these authorities, I have come to the conclusion that as a matter of law, it is permissible for a party to seek the opinion of the Court on questions additional to those framed in the Case Stated provided that such questions may fairly be said to arise out of the stated findings and decision of the Board.

Mr Barlow invited me to hold that if this was the principle, the additional question raised does not arise out of the findings before me. I do not agree. In my view, the findings clearly permit the Court to express an opinion as to whether the Board was in a position to hold that the Hong Kong Company either did or did not pay the Taxpayer for the right to use the trademarks in Hong Kong for the purposes of section 15(1)(b). I therefore rule that the additional question should be answered and provide the Court's answer later in this judgment.

I should add that Mr Barlow indicated that he would not seek an adjournment but would deal with the additional question "de bene esse", which he did in the course of the hearing. He also expressly reserved the right to argue in a higher court that the *Rico* decision is wrong.

The Taxpayer's primary case

As I have stated above, the Taxpayer's primary contention is that under section 15(1)(b), receipts are to be regarded as sums received "for the use of in Hong Kong .... a trademark" if, but only if, the use in question involves the sale in the Hong Kong market of goods bearing such trademark.

This is said to be the natural and ordinary meaning of the words in section 15(1)(b) or alternatively, the technical meaning of the phrase "use of a trademark" by virtue of trademark law which should, if necessary, be adopted.

If either of these arguments is correct then, in the light of the Board's finding that no selling activities were conducted in Hong Kong [Case Stated §5(iv)], it would follow that the receipts were not "for" any relevant use of the trademark in Hong Kong and so would fall outside the deeming provision.

In the course of the hearing, Mr Barlow made it clear that his argument is that the receipt must derive *exclusively* from use of the mark in Hong Kong. He submitted that even if all the goods had been manufactured and had the trademark affixed to them in Hong Kong before being exported and sold in the United States, section 15(1)(b) could not apply. This was so, he argued, not only because such manufacture was not to be regarded as "use of a trademark" (as discussed above), but also because the Royalty Agreement only made royalties payable in consequence of the sale of the goods so manufactured.

I am, with respect, unable to accept Mr Barlow's argument. Both as a matter of ordinary language and, as a matter of trademark law (discussed below), it is in my view clear that where a trademark is used in relation to goods, such "use" may take a variety of forms, involving different activities and different persons in the course of the production, marketing and eventual sale of the goods. Some such uses may take place in one country, e.g., where the goods are manufactured, and other uses may occur in another, e.g., where the goods have been exported for sale. A licensing agreement will often authorize a range of dealings with the trademark and will not restrict use either geographically or to selling goods on which the mark is affixed. This is applies to clause 2 of the Royalty Agreement in the present case. It provides that "(The Hong Kong Company) agrees to pay (the Taxpayer) for the use of the 'Emerson' trademark on products it sells to its US customers". It clearly permits not merely the act of selling trademark goods, but also "use of the mark on products" in the licensee's prior activities, as in the manufacture of the products bearing the mark. While the sales are intended to take place in the United States, it does not restrict such other uses to any particular locality.

What section 15(1)(b) requires to be established is that the Taxpayer received sums "for the use of or right to use in Hong Kong a ..... trademark". It applies if there has been activity in Hong Kong in relation to certain goods which constitutes use of the trademark in Hong Kong and which forms an essential step in a process culminating in the Taxpayer's receipt of royalty in respect of such goods. I see no reason for holding that even where such use in Hong Kong is established, it is to be ignored and operation of section 15(1)(b) excluded simply because there is a further use of the trademark in the foreign country where the goods are sold, culminating in the taxpayer's receipt of the royalty. To construe the provision in this way involves importing into the section a requirement that the use in Hong Kong must be the sole, exclusive and sufficient reason for receipt of the royalty. I see no warrant for reading any such restriction into the section.

In his alternative argument, Mr Barlow cited *Maunsell v Olins* [1975] AC 373 and *R v Chard* [1984] 1 AC 279, and invited me to construe section 15(1)(b) on the basis that "use of a trademark" was a term of art, the meaning of which was to be ascertained by reference to the Trade Marks Ordinance (Cap 43) as it stood in 1971 (when section 15(1)(b) was brought into the Inland Revenue Ordinance by amendment) and by reference to judicial decisions in relation to the use of trademarks.

I do not consider that the principles in *Maunsell v Olins* and *R v Chard* have any application in the present case. As Lord Diplock pointed out in the latter decision (at p 291), those principles are concerned with: "..... the role that judicial construction of particular words and phrases used in previous statutes may play in the interpretation of the same words in subsequent statutes *in pari materia*". I am concerned with construing words in the Inland Revenue Ordinance which are not *in pari materia* with any words in the Trade Marks Ordinance.

It is true that the latter Ordinance does legislate as to the use of trademarks in various different contexts, e.g., as to what constitutes an infringing use; or as to what constitutes lack of use justifying the expunging of registration. Mr Barlow cited various examples, including *Massam v Thorley's Cattle Food Company* [1880] 14 Ch D 748; *Re Munch's Application* [1884] LT 12; *Jackson v Napper* [1887] RPC 45; and *Estex Clothing Manufacturers v Ellis & Goldstein* (1966-1967) 116 CLR 254. However, I unable to see why judicial considerations of "use of a trademark" in such particular and varied contexts should apply to narrow the meaning of the provisions of section 15(1)(b).

This is particularly so since section 15(1)(b) deems certain receipts chargeable not merely in respect of the use of a trademark but also in respect of use of a "patent, design, ... copyright material or secret process or formula or other property of a similar nature". I do not accept that it was intended that judicial decisions grappling with various types of use for various purposes in relation to all these different forms of intellectual property should be read into the provision so as to modify the ordinary meaning of the words in section 15(1)(b). In my view, "use" of the various forms of intellectual property listed is to be given a broad and non-technical meaning.

Even if I am wrong in the view just expressed, I consider that the Taxpayer derives no assistance from references to trademark law. On the contrary, it appears to me that the provisions of the Trade Marks Ordinance and judicial decisions on what may constitute "use of a trademark in relation to goods" favour the non-restrictive construction of "use" which I have held to apply.

Mr Barlow emphasised the importance of the definition of "trade mark" which was in the following terms[1] :-

> "'trade mark' means ..... a mark used for the purpose of indicating or so as to indicate, a connexion in the course of trade between the goods and some person having the right either as proprietor or as registered user to use the mark, ..."

He argued that this shows that a trademark should only be regarded as "used" when it was used "in the course of trade" which, in turn, he submitted, means "used in the course of selling the goods".

I am unable to accept this argument. In my view, Mr Barlow seeks to attribute to the definition of "trade mark" a function which it was not intended to perform and a construction which is contrary to authority.

The definition in the Trade Marks Ordinance follows that used in the Trade Marks Act of 1938. In *Aristoc Limited v Rysta Limited* [1945] AC 68, the House of Lords considered the effect of such definition and in particular, whether it changed the essential meaning of "trade mark" established at common law and by its predecessor, section 3 of the Trade Marks Act 1905. Their Lordships held that it did not.

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[1] As Mr Barlow referred at the hearing to Ordinance No. 47 of 1954 as containing the 1971 version of the Trade Marks Ordinance, I shall do the same. I should however say that I am not convinced that such an approach is dictated by any applicable principle of statutory construction.

Viscount Maugham pointed out (at p 89), that at common law, it was established that "..... (The) function of a trade mark is to give an indication to the purchaser or possible purchaser as to the manufacture or quality of the goods - to give an indication to his eye of the trade source from which the goods come, or the trade hands through which they pass on their way to the market" as Bowen LJ held in *In re Powell's Trade* [1893] 2 Ch 388 at 403-4. Under the 1905 Act, a trade mark was defined as "..... a mark used or proposed to be used upon or in connexion with goods for the purpose of indicating that they are the goods of the proprietor of such trade mark by virtue of manufacture, selection, certification, dealing with, or offering for sale." Although the wording in the 1938 definition was wider, their Lordships held that the fundamental function of a trademark had not altered. Lord Macmillan put it as follows (at p 97):

> "A trade mark must still be registered in respect of goods, it must be used in relation to goods, it must indicate a connexion in the course of trade between goods and the user of the trade mark. A trade mark must thus be used in trade. 'Trade' is no doubt a wide word but its meaning must vary with and be controlled by its context. A connexion with goods in the course of trade in my opinion means, in the definition section, an association with the goods in the course of their production and preparation for the market. After goods have reached the consumer they are no longer in the course of trade. The trading in them has reached its objective and its conclusion in their acquisition by the consumer."

It follows, in my view, that the section provides a definition of a "trade mark" by reference to its purpose. It is a mark which indicates who made the goods or selected or certified them or who is offering them for sale. It is closely associated with the goodwill of the person in question since such person may have acquired a reputation for manufacturing, selecting or selling high quality goods. A mark showing a trade connexion with such person draws on such goodwill. All of this bears on the meaning of "trade mark". None of it bears on the meaning of "use of a trade mark". Still less does it require one to conclude, as Mr Barlow argues, that a trademark cannot be regarded as "used" save when one is selling or offering goods for sale bearing that mark. On the contrary, it plainly envisages use of the mark in relation to the goods in the course of their production and preparation for the market.

Other sections of the Trade Marks Ordinance give guidance as to the meaning of "use". Thus, section 39(1) (of the version of the Ordinance relied on by Mr Barlow) specifically provided that:-

> "The application in the Colony of a trade mark to goods to be exported from the Colony, and any other act done in the Colony in relation to goods to be so exported which, if done in relation to goods to be sold or otherwise traded in within the Colony, would constitute use of a trade mark therein, shall be deemed to constitute use of the trade mark in relation to

> those goods for any purpose for which such use is material under this Ordinance or at common law."

Section 39 therefore expressly deemed, inter alia, application of the mark to the goods in Hong Kong to be use of the trademark here. There could, in my view, hardly be a clearer indication that "use of a trademark" is not confined to use involving the sale of the goods in question, whether for the purposes of trademark or revenue law.

Additionally, section 2(2) of the said version of the Ordinance provided as follows:-

> "References in this Ordinance ..... to the use of a mark in relation to goods shall be construed as references to the use thereof upon, or in physical or other relation to, goods."

This provision mirrors section 68(2) of the Trade Marks Act 1938 and has been construed to cover a very wide range of activities in relation to a trademark.

For instance, the English equivalent was considered by Falconer J in *Hermes Trade Mark* [1982] RPC 425; his Lordship holding that the words "use ..... in physical or other relation" to the goods "would cover the use of the mark ..... for example, in advertisements, in invoices, in orders and so on" (at p 429) and that "use in the course of trade" included use of the trade mark in the course of acquiring the goods for future sale (at p 430). Similarly, Morrit J in *Cheetah Trade Mark* [1993] FSR 263 held that for the purposes of section 68(2) of the 1938 Act, "The use described as ancillary use [i.e., of a mark on invoices and delivery notes] is just as much an infringement under English law as stamping the word CHEETAH on the container." The same broad approach was adopted in Hong Kong by Rogers J in *Stichting Greenpeace Council v Income Team Limited trading as Green Peace and Others* [1996] 1 HKLR 269, where a wide range of activities was held to constitute use of a trademark in relation to goods.

It follows in my view, that far from helping Mr Barlow establish his restrictive construction of section 15(1)(b), reference to the approach adopted in the law of trade marks supports the contrary view.

I would only add that I can see nothing in the construction adopted which gives the section any extra-territorial operation - a consequence which Mr Barlow was at pains to caution against. The foreign proprietor is taxed only in respect of royalties earned from use of the trademark in Hong Kong in a manner essential to the generation of that royalty. It is the Hong Kong profit-generating activity that triggers the charge.

I therefore reject the Taxpayer's primary case. The fall-back position adopted by both parties is considered later.

The Commissioner's primary case

As indicated above, the Commissioner's primary case is that the Board's findings establish that there has been relevant use of the "Emerson" trademark in Hong Kong and that all of the royalties received by the Taxpayer were paid for such use so that they fall within section 15(1)(b). Four alternative arguments were advanced by Mr Fok in support of this contention.

The first is summarised in Mr Fok's skeleton argument (with my abbreviations substituted) as follows:-

> "The Taxpayer used the trademark in Hong Kong by licensing ERHK, a Hong Kong company carrying on business in Hong Kong and paying Hong Kong tax in respect of all its profits, to use the trademark. For this use by the Taxpayer of the trademark, the Taxpayer received the royalty payments in each of the relevant years."

It will be observed that this argument depends on use of the trademark by the Taxpayer, i.e., by the proprietor of the mark, rather than use by the Hong Kong licensee. Mr Fok argued that such a construction was open to him since section 15(1)(b) was silent as to the identity of the persons who have to use the trademark to trigger its provisions. Accordingly, it was contended, the Taxpayer had "used" the trademark by entering into the Royalty Agreement thereby commercially exploiting that trademark. It was argued that this had taken place in Hong Kong since it was in Hong Kong that the licensee operated and enjoyed the benefits of the licence.

I am unable to accept this construction of section 15(1)(b). In order to fall within its terms, the Taxpayer must receive sums *for* the use of, or *for* the right to use, the trademark in Hong Kong. Such language is apt to describe situations where the Taxpayer receives payment in return for or in exchange for his permitting some other person, i.e., the licensee, to use the trademark. The sum received is the quid pro quo *for* allowing another person to use the trademark or *for* granting the right to use the trademark to such other person. In my view, the language of section 15(1)(b) is not apt for describing cases where the Taxpayer receives sums in consequence of or by virtue of his own use of the trademark by the act of granting a licence to use it. It strains language excessively to say that in such cases, the Taxpayer received the money *for* his own use of the mark.

It is therefore my view that section 15(1)(b) implicitly does identify the person using the trademark as a person other than the person who receives the payment or to whom the payment accrues, i.e., a person other than the Taxpayer. It follows that I reject the Commissioner's first argument in support of its primary case.

The Commissioner's second argument in support of its primary case is summarised in the skeleton argument as follows:-

> "The Hong Kong Company paid the royalty payments for the right to use the trademark in Hong Kong. This was granted by the Royalty Agreement which contained no geographical restriction on where the Hong Kong Company was to or could use the trademark. Thus, there was plainly a right to use the trademark in Hong Kong ..... in return for which the Hong Kong Company paid royalties to the Taxpayer ..... It was a matter entirely for the Hong Kong Company to decide where to manufacture those goods. If, in the light of rising labour costs, it chose to have the goods manufactured elsewhere in Asia, that was a matter entirely for the Hong Kong Company but did not affect the obligation to pay royalties to the Taxpayer."

I quite agree that by the Royalty Agreement, (i) the Taxpayer granted to the Hong Kong Company the right to use the relevant trademark; (ii) this included the right to use the trademark in Hong Kong; and (iii) it was left up to the Hong Kong Company to decide in which country it might wish to exercise the right of manufacturing the relevant goods. However, in my judgment, this does not suffice to bring the whole of the royalties within section 15(1)(b). What the Commissioner has failed to do is to show that the whole of the Taxpayer's receipts *derives from* the grant of the right to use the trademark in Hong Kong.

Section 15(1)(b) requires it to be shown that the Taxpayer received sums "for the use of or right to use in Hong Kong a ..... trademark". As pointed out above, it is my view that where there has been actual use in Hong Kong, section 15(1)(b) operates on particular receipts if those receipts have been paid to the Taxpayer for such use in Hong Kong of the trademark, such use constituting an essential (but not the only necessary) step in the process culminating in such receipts. Where the right to use the trademark (as opposed to its actual use) in Hong Kong is relied on to trigger section 15(1)(b), it is my view that section 15(1)(b) only operates if the sums received derive from the Taxpayer's grant of that right, in the sense that such grant of the right constituted an essential step leading to payment of the royalties in question.

As the Board found, some of the Taxpayer's receipts derived from the sale (mainly in the United States) of goods which the Hong Kong Company caused to be manufactured (with the trademark affixed thereon) in Hong Kong. As I have already indicated, such manufacture in my view does involve a relevant use of the trademark in Hong Kong. It would also, in my opinion, be true to say that the Taxpayer received such sums not only for the use of the trademark, but also for having granted the licensee the right to use the trademark in Hong Kong. This is so since the Hong Kong Company was lawfully permitted to use the trademark in the manufacturing process by virtue of the right to use the trademark granted to it under the Royalty Agreement. The grant and exercise of that right were therefore both essential parts of the process culminating in the Taxpayer's receipt of royalty in relation to the goods manufactured in Hong Kong, bringing the sums so earned within section 15(1)(b)'s net.

However, the Taxpayer's royalty receipts in respect of goods which were manufactured, marketed and sold wholly outside Hong Kong, without involving any exercise of the right to use the trademark in Hong Kong, do not activate section 15(1)(b). True it is that even in relation to such off-shore goods, the Hong Kong Company enjoyed the legal right to use the trademark in Hong Kong, if it chose to do so. However, the existence of that unexercised right played no part in the process which culminated in the Taxpayer's royalty receipts in respect of those off-shore goods. The royalty-producing right which the Hong Kong Company exercised in this context was the right to use the trademark in countries outside of Hong Kong.

I therefore reject the second argument advanced in support of the Commissioner's primary case in so far as it relates to goods other than those found by the Board to have been manufactured in Hong Kong.

The Commissioner's third argument in support of its primary case is summarised in the skeleton argument as follows:-

> "The Hong Kong Company paid the royalties for the use of the trademark in Hong Kong which it used in connection with the business carried on by it in Hong Kong and on all of the profits of which it paid Hong Kong profits tax. The royalties paid to the Taxpayer form part of the business expenses of the Hong Kong Company in earning that profit and are therefore Hong Kong source deductions within s. 16(1) ..... As the royalties are clearly treated as expenses to earn Hong Kong source profits, it follows that the trademark was used in the Hong Kong Company's profit-generating activities in Hong Kong."

It would appear that this argument also underpins the Board's decision, which I have set out above.

With respect, it is my view that this argument is fallacious. The Hong Kong Company had to pay profits tax because it fell within the section 14 charge. This was so because it carried on a trade or business in Hong Kong and because its profits were the profits of that trade or business and were sourced in Hong Kong. None of this implies necessarily or at all that there has been any relevant use of the trademark in Hong Kong so as to activate section 15(1)(b). Use of the trademark as part of the Hong Kong Company's business may obviously have occurred outside of Hong Kong without derogating from the conclusion that the Hong Kong Company's profits arose in or derived from Hong Kong where it conducted its operations. In other words, specific activities constituting use of the trademark must be shown for section 15(1)(b) purposes. It is a non sequitur to argue merely from the fact of the Hong Kong Company's liability for Hong Kong profits tax to the conclusion that the Taxpayer's receipts derive from use of the trademark in Hong Kong.

The Board found that the Hong Kong Company's local operations comprised its handling of paperwork for the sale of goods, receiving purchase orders from the

Taxpayer, issuing purchase orders to manufacturers, arranging and handling letter of credit facilities, co-ordinating shipments of goods and liaising with manufacturers concerning production of goods. As the authorities discussed above (in particular, *Hermes Trade Mark* [1982] RPC 425, *Cheetah Trade Mark* [1993] FSR 263 and *Stichting Greenpeace Council v Income Team Limited trading as Green Peace and Others* [1996] 1 HKLR 269) suggest, such activities might well involve ancillary use of a trademark. If so, such ancillary use might or might not constitute sufficient use for the purposes of section 15(1)(b). However, it was accepted by the Commissioner that in the present case the Board's findings do not establish that these activities in fact involved any use of trademark so that the point does not arise.

Mr Fok sought to rely on the fact, found by the Board, that certain goods had been trans-shipped in Hong Kong as an instance of relevant use of the trademark here. However, the Board's findings give no indication that such trans-shipment involved any use of the trademark at all. Indeed, it seems likely that the electrical and electronic home entertainment products in question may have transited Hong Kong packed inside shipping containers with no one ever seeing the "Emerson" trademark during that process.

I accordingly reject the Commissioner's third argument in favour of his primary case. It follows that I also find that the basis upon which the Board reached its Decision was fallacious.

The Commissioner's fourth (and final) argument in support of his primary case is summarised as follows:-

> "The Hong Kong Company used the trademark in Hong Kong in placing the trademark on goods manufactured in Hong Kong. Each royalty payment was a single indivisible sum and was paid on all of the Hong Kong Company's sales the profits of which were all Hong Kong source profits. The use of the trademark in Hong Kong by the Hong Kong Company in this way is therefore the basis for deeming the whole royalty payment to be a Hong Kong source profit for the Taxpayer and no apportionment of the royalty payment is necessary or appropriate."

As I have indicated above, it is my view that the application of the trademark on goods in the course of their manufacture in Hong Kong constitutes a relevant use of the trademark. I therefore agree with the first sentence in the passage just cited.

However, I cannot accept the suggestion in the next sentence that each royalty payment was "a single indivisible sum". Under the Royalty Agreement, royalty payments represented a percentage of US sales achieved. It seems clear that such payments are in principle divisible, and that it is possible to relate particular sums of royalty to the sale of particular goods deriving from use of the trademark in Hong Kong.

Once it is accepted that royalties received are divisible, the Commissioner's fourth argument falls away. Being divisible, the royalties deriving from the Hong Kong use of the trademark can be segregated from royalties earned from off-shore use and no need or legal justification arises for "deeming the whole royalty payment to be a Hong Kong source profit for the Taxpayer".

I accordingly also reject the Commissioner's fourth argument in support of his primary case.

Apportionment

It will have been evident from the construction which I have adopted for section 15(1)(b) and from my foregoing comments on the present facts that in my view, an apportionment of the Taxpayer's receipts is required for the purposes of Hong Kong profits tax. Despite the absence of express machinery in the Ordinance, the availability in principle of apportionment was recognized by the Privy Council in *CIR v Hang Seng Bank Ltd* [1991] 1 AC 306 at 321-2. Furthermore, as I have stated, both parties adopted apportionment as their fall-back position. I am also told by Mr Barlow that apportionment in the present case ought to present no practical problems.

Accordingly, in my judgment, only those receipts or accruals representing royalties paid or credited to the Taxpayer in relation to goods whose production and sale involved use of (and so also the right to use) the trademark in Hong Kong as an essential step in producing those receipts or accruals, are caught by the deeming provisions of section 15(1)(b). In the present case, this means that the royalties received or accrued in relation to the sale of goods manufactured in Hong Kong must be segregated from other royalties. Only the former class of royalties attracts the charge to profits tax.

Answers to the questions posed and the additional question

I answer Questions 1, 2 and 3(i) framed in the Case Stated for the opinion of the Court in the negative. I answer Questions 3(ii) and 4 therein in the affirmative. The answer which I give to the Additional Question is: "Yes, but only in respect of the goods found to have been manufactured in Hong Kong."

I accordingly Order that :-

1. The decision of the Board of Review be set aside;

2. This Case be remitted to the Board of Review with this Court's opinion thereon, and that :-

   (1) the Board of Review be directed, in respect of the years of assessment in question, to identify royalty payments received by the Taxpayer arising out of the sale of goods manufactured in Hong Kong bearing the Taxpayer's

trademark and to segregate such receipts from other receipts of royalty from the Hong Kong Company; and

(2) the said assessments be reduced and confined to the sums chargeable on the royalty receipts deriving from the goods manufactured in Hong Kong as aforesaid.

Order nisi as to costs

The Taxpayer has succeeded on the appeal to the extent that the assessments will be reduced to tax payable on the apportioned receipts which, I understand, may involve a substantial reduction of tax payable. However, it is true to say that the great bulk of the hearing was devoted to both parties seeking to make good their primary cases, each of which I have rejected. Apportionment was hardly debated since apportionment as a fall-back position was common to both parties.

If the Taxpayer had confined its appeal to an argument in favour of apportionment, it is possible that the hearing might not have had to take place. It would certainly have been a much shorter hearing. However, it is also true that the Commissioner did not seek to resist the appeal solely on the basis that the apportioned receipts attracted the charge. He sought to justify the Board's Decision as a whole.

In all the circumstances, I consider that the Taxpayer should make have an order nisi for part, but not all of its costs.

By way of an order nisi, I Order that the Commissioner do pay half of the Taxpayer's costs of this Appeal to be taxed if not agreed.

(Robert Ribeiro SC)
Recorder of Court of First
Instance of the High Court

Mr Barrie Barlow, instructed by Messrs Baker & McKenzie for Taxpayer (Appellant)
Mr Joseph Fok, instructed by Secretary for Justice for Commissioner (Respondent)