HCIA 5/2001

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

INLAND REVENUE APPEAL NO. 5 OF 2001

BETWEEN

COMMISSIONER OF INLAND REVENUE Appellant

AND

INDOSUEZ W I CARR SECURITIES LTD Respondent

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HONG KONG SPECIAL ADMINISTRATIVE REGION
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BETWEEN

COMMISSIONER OF INLAND REVENUE Respondent

AND

INDOSUEZ W I CARR SECURITIES LTD Appellant

Before: Deputy High Court Judge Longley in Court
Date of Hearing: 17 December 2001
Date of Judgment: 18 December 2001

R U L I N G

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1. Miss Li, for the Commissioner, invites the court to look at the Determination of the Commissioner dated 2 July 1999.

2. She does so because of the reason given by the Board of Review (in para. 34 of the Case Stated) for finding that the profits generated from the execution of orders on overseas markets for overseas clients arose substantially from an offshore source. The Board took this view on the basis that the overseas offices of the group to which the tax-payer belonged were the agents of the tax-payers in the maintenance of the relationship with the client, the processing, handling and management of the orders and the provision of primary research materials.

3. Miss Li's submission is essentially that there was no evidence to support the conclusion that there was such agency, or that such a conclusion could not reasonably be reached.

4. The Board itself accepted, notwithstanding the onus on the tax-payer under s.68(4) of the Inland Revenue Ordinance to prove that the assessment was erroneous, that there was no direct evidence on the question and that the tax-payers had not adduced any evidence as to the contractual relationship between itself and the various offices or its associated companies within the group (see paras. 29 and 30 of the Case Stated).

5. But the Board of Review said (in para. 31 of the Case Stated) that it did not "consider that the absence of such direct evidence indicates that the tax-payer was unable to produce such evidence". The reason given for reaching that conclusion was the fact that Mr Thomson for the tax-payer in his opening submissions had quoted from a paragraph in the Reasons given by the Commissioner in which the Commissioner had said that it was clear that commission was earned when customers' orders had been carried out by the tax-payer "through agents in the Stock Exchanges outside Hong Kong" and that there had been no demur on the part of counsel for the Commissioner to this assertion by Mr Thomson. This passage is set out in para. 29 of the Case Stated.

6. The Board of Review said that this could explain the failure of the tax-payer to call direct evidence of the contractual relationship between the tax-payer and the overseas offices.

7. Miss Li's main point, as I understand it, is this, that the passage cited by Mr Thomson in his opening before the Board and cited in para. 29 of the case stated was a reference to overseas brokers, not to the group's overseas offices when they liaised with clients, or solicited or handled orders or provided primary search materials. The Board of Review was therefore not entitled to conclude that the failure of the Commissioner's counsel to demur to this passage led the tax-payer to believe it did not have to adduce evidence as to the contractual relationship with other companies or offices in the group in so far as liasing with clients, soliciting and handling orders etc were concerned.

8. Miss Li says that the context of this passage in the Commissioner's reasons makes it clear to what it refers and that the court should therefore look at it.

9. She referred to the case of *Carvill v Commissioners of Inland Revenue* 70 TC 126 in which it was stated that it was usual practice for the Commissioner to transmit to the High Court with a case stated copies of any documents proved or admitted at the hearing and that the Judge hearing the appeal can be referred to such documents for the purpose of amplifying the case stated.

10. Miss Li also invites the court to look at a fact in the Commissioner's Determination under the heading "Facts upon which the determination was arrived at" which were agreed for the purpose of the hearing before the Board of Review. She contends that this fact supports the view that the Board of Review's reference to overseas clients was to them being the clients of their particular overseas office.

11. Mr Smith for the tax-payer has referred the court to the decisions of Kaplan J and Barnett J in the *Aspiration Land* cases ((1990) 3 HKTC 395 and (1988) 2 HKTC 575) in support of the proposition that in Hong Kong, the basic requirement of a case stated is that it should, save in exceptional circumstances, be complete in itself.

12. It should be noted however that in those cases what the Commissioner was seeking to do was to attack the Board's findings of primary fact which had been the basis of the Board's conclusions through the evidence which had been adduced before the Board. This, as Barnett J pointed out, would effectively require the court to re-hear the whole review on paper without the benefit of hearing witnesses. The Commissioner was not simply seeking to challenge that there was no evidence to support a particular finding of fact. He was in effect seeking to challenge the Board's findings of primary fact based on the evidence. The Board would then in effect be reconducting a trial on the facts, not deciding an issue of law.

13. In this case, what Miss Li seeks to do is quite different. She asks the court to look at the context of the passage quoted in para. 29 of the Case Stated so that the court is left in no doubt as to what it related and that there was nothing which could have amounted to such an admission by the Commissioner. She is not seeking to attack a finding of primary fact but to clarify a passage from which the court drew an inference. In so far as she seeks to rely upon a passage under the heading "Facts upon which the

determination was arrived at", she is not seeking to attack the Board's findings of fact. There is no doubt that the facts under the heading were agreed by the parties. The Board did not therefore have to make a finding of fact in relation to them. They were consequently primary facts before the Board which could be used by the Board to find its conclusions.

14. I allow Miss Li's application that the court should look at the Commissioner's Determination for the purposes she has outlined.

(P K M Longley)
Deputy High Court Judge

Representation:

Ms Gladys Li, SC, instructed by Department of Justice for Commissioner of Inland Revenue (Appellant in HCIA 5/01 and Respondent in HCIA 4/01)

Mr Clifford Smith, SC, leading Mr Meil Thomson, instructed by Messrs Johnson, Stokes & Master for Respondent in HCIA 5/01 and Appellant in HCIA 4/01

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INLAND REVENUE APPEAL NO. 5 OF 2001

BETWEEN

COMMISSIONER OF INLAND REVENUE	Appellant
AND	
INDOSUEZ W I CARR SECURITIES LTD	Respondent

AND

HCIA 4/2001

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

INLAND REVENUE APPEAL NO. 4 OF 2001

BETWEEN

COMMISSIONER OF INLAND REVENUE	Respondent
AND	
INDOSUEZ W I CARR SECURITIES LTD	Appellant

INLAND REVENUE BOARD OF REVIEW DECISIONS

Before: Deputy High Court Judge Longley in Court
Date of Hearing: 17-20 December 2001
Date of Judgment: 30 January 2002

J U D G M E N T

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1. This is an appeal by way of case stated from the Decision of a Board of Review dated 28 August 2001 pursuant to S. 29 of the Inland Revenue Ordinance Cap. 112.

2. At the hearing before the Board of Review (the "Board") held on the 4 and 5 January 2000, Indosuez W I Carr Securities Ltd (the "Taxpayer") had appealed against a Determination of the Commissioner of Inland Revenue (the "Commissioner") dated 2 July 1999 in respect of the Taxpayer's additional profits tax assessments for the years of assessment 1992/93 and 1993/94 and the profits tax assessment for the year of assessment 1994/95 (the "Assessments").

3. By Notices of Appeal against the Commissioner's Determination dated 30 July 1999, the Taxpayer had challenged the Commissioner's Determination contending that the reduced Additional Assessable Profits for each of the said 3 years of assessment, i.e. 1992/93, 1993/94 and 1994/95 ("the relevant years of assessment") were profits which neither arose in nor were derived from Hong Kong and were therefore outside the scope of the charge to profits tax imposed by S.14 of the Inland Revenue Ordinance.

4. The appeal before the Board therefore raised the question of source of profits.

5. The Assessments were made in respect of "commissions and brokerage" and "interest" received by the Taxpayer in the respective years and also in respect of placement fees (underwriting commission) received in 1994/95. The Assessor contended that the said sums were chargeable to profits tax under section 14(1) of the Inland Revenue Ordinance ("IRO") on the basis that they were assessable profits arising in or deriving from Hong Kong from a trade or business carried on by the Taxpayer in Hong Kong.

6. From the facts which the parties had agreed the Board of Review found inter alia the following facts proved:

(a) The Taxpayer was incorporated as a private company in Hong Kong on 7 October 1986 and commenced to carry on business as a stockbroker in Hong Kong on 1 May 1987.

(b) The Taxpayer is and was at the material time a member of an international stockbroking group. During the relevant years of assessment, the group maintained subsidiaries and offices at various places including New York, London, Singapore, Indonesia, Taiwan, Thailand and Japan.

(c) The ultimate holding company of the Taxpayer at the time was Compagnie de Suez incorporated in France.

(d) The Taxpayer's office in Hong Kong served as the centre or headquarters of the group for the Asia pacific region.

(e) At the material time, the Taxpayer's offices in Hong Kong occupied five floors (although not the entire five floors) of One Exchange Square.

(f) It also incurred substantial expenses for salaries and allowances during each of the relevant years of assessment. By the end of 1995, there were over 200 staff working in the Hong Kong office.

(g) The Taxpayer derived income from brokerage commission both in respect of the Hong Kong market and overseas markets. Overseas markets would appear to cover stock markets in Thailand, Singapore, Indonesia, India, Korea and Taiwan. Brokerage commission generated from the Hong Kong market had always been offered for assessment. For the years of assessment 1987/88 – 1991/92, the Assessor had accepted the Taxpayer's claim that its profits or loss from its brokerage business in respect of overseas markets were offshore.

(h) In 1993, the Assessor commenced a review of the Taxpayer's offshore claim. Pending the outcome of the review, the Assessor issued to the Taxpayer profits tax assessments for the years of assessment 1992/93 and 1993/94 in accordance with the Taxpayer's returns for these 2 years.

(i) Subsequently the Assessor issued to the Taxpayer additional assessments on the basis inter alia that its profits derived from commissions arising from execution of transactions on overseas stock exchanges were profits arising in or derived from Hong Kong and were accordingly taxable by virtue of S. 14 of the Inland Revenue Ordinance Cap.112.

7. At the hearing before the Board of Review, the Board was concerned not only with these profits from commission income, but also with certain interest income and corporate finance income of the Taxpayer. The Board made certain findings in relation to interest income and corporate finance income, but these findings are not the subject of the case stated before this court. This court is solely concerned with the Taxpayer's profits from commission arising from the execution of orders placed on overseas stock exchanges.

8. Two witnesses were called by the Taxpayer before the Board of Review Mr Jean-Luc Eymery, the Chief Financial Officer, and Mr Keith Craig, the Group Head of Sales. The Board accepted their evidence as to the primary facts and in paragraph 8 of the case stated set out its findings on the basis of the evidence of these witnesses. I do not propose to set out those findings in full but shall refer to them in so far as they are relevant to the issues before the court.

9. Initially during the hearing before the Board of Review, no distinction was drawn in respect of orders placed on overseas markets between orders placed in Hong Kong by Hong Kong customers and orders placed outside Hong Kong by overseas customers. Counsel for the Taxpayers argued that all the commission profits in question were offshore whereas counsel for the Commissioner argued that the Taxpayer had not proved its case. It was only during the course of the hearing that it appeared to the Board that a distinction might be drawn between the two.

10. Ultimately the Board of Review did draw a distinction in its conclusions.

The Board's conclusions

Overseas customers

11. In so far as commission earned from the execution of orders in the overseas markets from clients outside Hong Kong is concerned, the Board came to the conclusion that the source of commission generated from overseas clients was substantially offshore and therefore not liable to taxation. It is significant that it did not do so on the basis that the execution of the orders on overseas markets was done by brokers acting as the agents of the Taxpayer thereby making the acts of the brokers acts of the Taxpayer performed overseas. Indeed it specifically found that it could not infer that the brokers were the Taxpayer's agents and consequently it would not be right to regard the actual execution of the order at the markets as the acts of the Taxpayer. The Board did so on the basis that the Taxpayer engaged the overseas offices of its group as its agents to perform the tasks of liaising with clients, processing, handling and managing the orders and providing primary research material. As a result of so doing the Board found that the profits generated from overseas clients arose substantially from an offshore source.

Hong Kong customers

12. In so far as commission earned from the execution of orders in overseas markets for clients in Hong Kong is concerned, the Board came to the conclusion that the profits could be said to be derived from operations carried on both within and outside Hong Kong. The greater element, which derived from the operations within Hong Kong, was a result of the Taxpayer's efforts in building up and maintaining the relationship with the clients, providing quality research and offering advice to the clients, providing an effective and reliable service to the clients and in projecting and maintaining an image of repute and reliability to the clients. Again the Board proceeded on the basis that the

actual execution of the orders on the overseas markets was not the act of the Taxpayer. If it had been permitted to do so the Board would have apportioned the profits derived from commission earned from Hong Kong clients to be 60% onshore and 40% offshore. It took the view however that it was bound by authority, which held that apportionment was not possible and that it had to look to the predominant source of the profit which was Hong Kong.

13. There are 5 questions posed by the Board of Review in its case stated.

Questions 1 and 3

14. Two of those questions Question 1 and Question 3 were posed at the instance of the Commissioner of Inland Revenue in order to challenge the Board's finding that the profits from commission from orders from overseas clients arose substantially outside Hong Kong and were not chargeable to tax. The questions are these:

> (1) Whether upon the evidence before the Board of Review and in all the circumstances of the case, the Board of Review erred in law in drawing an inference that the taxpayer engaged overseas offices as its agent in performing various tasks such as the maintenance of the relationship with the client, the processing, handling and management of the orders and the provision of the primary research materials.
>
> (3) Whether on the facts found by the Board of Review, the Board of Review erred in law in concluding that the profits generated by the Taxpayer from orders from overseas clients on overseas markets arose substantially outside Hong Kong and are not chargeable to tax.

15. These questions therefore centre on the question of the agency of the overseas offices within the group and relate to orders placed by overseas customers.

Questions 2, 4 and 5

16. Questions 2, 4 and 5 have been posed by the Taxpayer.

17. Question 2 and 4 centre on the Board's finding that the actual execution of an order on the overseas stock exchanges was not the act of the taxpayer, but predominantly the act of local overseas brokers engaged by the relevant office as independent contractors. The questions are as follows:

> (2) Whether on the facts as found by the Board of Review, the Board of Review erred in law in not concluding that the actual execution of the orders at the overseas market were the acts of the Taxpayer performed through its agents, the brokers.
>
> (4) Whether on the facts found by the Board of Review, the Board of Review

erred in law in concluding that the source of profits generated by the Taxpayer from orders from Hong Kong clients executed on overseas markets was predominantly Hong Kong or that Hong Kong was where the acts more immediately responsible for the receipt of the profits were undertaken.

18. Question 5 posed by the Taxpayer is as follows:

(5) Whether the Board of Review was correct in law in determining that it was not permitted by law to apportion the profits derived from commission earned from Hong Kong clients from the execution of orders in the overseas market, which the Board of Review would otherwise have done on the basis of 60% onshore and 40% offshore on the facts as found by the Board of Review.

The law

19. Neither party has sought to challenge the Board's findings as to the applicable law which it set out in the following terms:

"Three conditions must be satisfied before a charge to tax can arise under section 14 of the Inland Revenue Ordinance. (1) The Taxpayer must carry on a trade, profession or business in Hong Kong. (2) The profits to be charged must be from such trade profession or business, i.e. the trade, profession or business carried on by the Taxpayer in Hong Kong. (3) The profits must be 'profits arising in or derived from' Hong Kong: *Commissioner of Inland Revenue v Hang Seng Bank Ltd* (1991) 1 AC 306, 318.

The parties are *ad idem* as to the broad guiding principle which applies in the present case, namely, that one looks to see *what* the Taxpayer has done to earn the profits in question and *where* he has done it [see *HK-TVBI v Commissioner of Inland Revenue* [1992] HKTC 468 per Lord Jauncey of Tullichettle at p.477. Mr Chan, S C points out, and we accept, that it is important to focus on what the *Taxpayer* - and not what other person or entity - has done, see *Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Ltd* (1992) 3 HKTC 703 at 729 per Fuad JA.

In the *HK-TVBI* case, Lord Jauncey observed at p.480 that:

"In the view of their Lordships it can only be in rare cases that a Taxpayer with a principal place of business in Hong Kong can earn profits which are not chargeable to profits tax..."

Mr Chan, S C further relied on Barnett J's observation in *Commissioner of Inland Revenue v Euro Tech (Far East) Limited* (1995) 4 HKTC 30 at p.56:

"It seems to me that Lord Jauncey was doing no more than state what is a common sense. If a Taxpayer has a principal place of business in Hong Kong, it is likely that it is in Hong Kong that he earns his profits. It will be difficult for such Taxpayer to demonstrate that the profits were earned outside Hong Kong and therefore not chargeable to tax."

Reference has also been made to *Commissioner of Inland Revenue v Hang Seng Bank* [1991] 1 AC 306, 322H per Lord Bridge:

"... the question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last resort a question of fact depending on the nature of the transaction. It is impossible to lay down precise rules of law by which the answer to that question is to be determined. The broad guiding principle, attested by many authorities, is that one looks to see what the Taxpayer has done to earn the profit in question. It he has rendered a service or engaged in an activity such as manufacture of goods, the profit will have arisen or derived from the place where the service was rendered, or the profit making activities carried on."

A little later on, Lord Bridge observed:

"There may, of course, be cases where the gross profits deriving from an individual transaction will have arisen in or derived from different places. Thus, for example, goods sold outside Hong Kong may have been subject to manufacturing and finishing process which took place partly in Hong Kong and partly overseas. In such a case the absence of a specific provision for apportionment in the Ordinance would not obviate the necessity to apportion the gross profit on a sale as having arisen partly in Hong Kong and partly outside Hong Kong..."

This suggests that in appropriate cases, it may be necessary to apportion the profits by reference to their source, and only that part of the profits, which arise in or are derived from Hong Kong should be subject to profits tax. Lord Bridge did not, however, define the circumstances which permit an apportionment exercise, as it was unnecessary in the Hang Seng Bank case."

Orders from overseas customers

20. As I have said the basis of the Board's finding that the profits generated from orders from overseas customers arose offshore was the Board's finding that the Taxpayer acted through the group's overseas offices, who were its agents in maintaining the relationship with its clients, processing, handling and management of the orders and the provision of the primary search material.

Miss Li's submissions

21. Miss Li's principal submission is that the Board committed a fundamental error of law in finding that the overseas offices were the Taxpayer's agents in the absence of any evidence that that was so. In so far as the question of agency is concerned, the Board reminded itself (paragraph 30) that by virtue of S. 68(4) of the Inland Revenue Ordinance, the Taxpayer bore the burden of proving that the assessment appealed against was erroneous or excessive, and admitted that "the problem remains that we have no evidence of the arrangements between the Taxpayer and the other companies or offices in the group". It nonetheless drew an inference of agency.

22. It first concluded that the failure of the Taxpayer to adduce direct evidence of the contractual relationship between the Taxpayer and the overseas offices was explicable because Mr Thomson in opening the case for the Taxpayer had referred to a passage in the Commissioner's finding to the effect that it was "clear.....that the commission was earned when customers orders were carried out by the (Taxpayer) through agents in the stock exchanges outside Hong Kong" without demur from Mr Chan, counsel for the Commissioner.

23. Miss Li alleges that since this passage was referring to the overseas local brokers who executed the orders, the first error of the Board was concluding that this could provide an explanation for the Taxpayer failing to adduce evidence of its contractual relationship with its overseas offices in relation to the task of liaising with clients and soliciting and handling orders. In any event she comments that decision not to lead any such evidence must have been made at the time its witness statements were made not at the hearing. Furthermore she says one would not expect one counsel to demur while another counsel for the opposing party was opening his case. The Board was aware that the Commissioner was relying on the absence of any such evidence.

24. The Board's second error was concluding that (since the Taxpayer's failure to call direct evidence was explicable for the above reasons) "it did not consider the absence of direct evidence indicates that the Taxpayer was unable to draw or produce such evidence" and then go on to say in paragraph 31:

> "in the circumstances we consider it right to draw the inference that the Taxpayer engaged the overseas offices as its agents to perform the task of liaising with clients including soliciting and handling any client's order".

Even if the absence of direct evidence was explicable which Miss Li argues it was not, the Board could not conclude *in the absence of evidence* that the Taxpayer engaged the overseas offices as its agents.

25. Miss Li went on to argue that the evidence which was before the Board indicated that the overseas offices were not the agents of the Taxpayer in performing these functions, indeed that the overseas customers were not the customers of the Taxpayer, but of the overseas offices. She referred to paragraph 1(8)(B)(d) of the Commissioner's Determination, which came under the heading "Facts upon which the determination was arrived at" which were admitted for the purpose of the hearing before the Board of Review.

According to that paragraph the Taxpayer's tax representatives, Messrs Price Waterhouse, had made the following admission in submissions made to the Assessor: "Our client is regional centre of the group's operations, therefore the transactions in question were booked in the company's account despite the fact that the customers were not its customers and the buying and selling are not handled by it". Miss Li said that this admission was supported by the evidence of the Taxpayers' own witnesses before the Board. She argued that paragraph 8(x) suggests that the overseas offices would contact their clients usually on a daily basis and "in many instances" this contact "was the actual point at which each sales contract was made". This was borne out by the witnesses evidence (see paragraph 8(xii)) that a typical order from an overseas client in an overseas market took the course of the overseas client placing an order to the overseas office and that, although it faxed the order sheet to Hong Kong, the copy of the order which was actually acted upon was sent directly by the overseas office to the office where the share transaction was to be executed.

26. Even though the overseas client would sign a "Client Agreement and Client Account Opening Form" with the Taxpayer (see paragraph 8(ix) of the Case Stated), the reality of the situation, which was what the court must look to, was that these were and remained the clients of the overseas offices. The reality was, she argued, that the Taxpayer was earning its profit from the transaction simply by:

(1) providing (presumably for tax reasons) the place where the transaction was booked;

(2) performing certain background functions.

Miss Li argues that the possibility that the Taxpayer was simply used for such a purpose was recognised by the Board in paragraph 30 when it said "It may be that the group had organised its affairs in such a way that all the profits (other than those generated from orders brought in by W I Carr (America) Limited and W I Carr (Singapore) Limited) arising from trading in the Asian market would go to the Taxpayer, presumably because Hong Kong has a low standard tax rate. "

27. Miss Li argues that this is no evidence that the overseas offices performed any of the functions referred to by the Board in paragraph 27 of the Case Stated as agents for the Taxpayer, namely:

(1) building up and maintaining a relationship with the client,

(2) providing quality research and offering advice to the client on the market generally and any stock in particular,

(3) providing an efficient and reliable service, not only in the execution of the orders, but generally in managing the client's account, and

(4) projecting and maintaining an image of repute and reliability.

28. Furthermore no inference could be drawn from the payment of "management fees" to overseas offices that the relationships between the Taxpayer and those companies was that of principal and agent.

Mr Smith's submissions

29. In so far as these orders from overseas clients executed on overseas markets are concerned Mr Smith contends that notwithstanding evidence which might suggest the contrary there was evidence from which the Board could reasonably conclude that the clients were those of the Taxpayer. These included the fact that the client would sign a client agreement with the Taxpayer (paragraph 8(ix)) and that the Taxpayer accepted responsibility for losses on dealing on securities including those in overseas exchanges (paragraph 58(1) and (4)), so that for instance, if the wrong stock were purchased, the loss would have to be borne by the Taxpayer. Furthermore documentary evidence of particular transaction was put before the Board (Appendices E1, E2 and E3 to the Commissioner's Determination) which showed inter alia the bought and sold notes in respect of orders on overseas customers placed in overseas markets were issued directly by the Taxpayer to the client. Although the letter from the Taxpayer's representatives may have stated that they were not the Taxpayers customers, the same representatives had made further submissions in a letter of 5 January 1996 (attached as Appendix G to the Commissioner's Determination), the tenor of which was to the opposite effect.

30. Regarding Miss Li's submissions in relation to paragraphs 29-34 of the Case Stated in which the Board concluded that the Taxpayer engaged the overseas offices as its agents to perform the task of liaising with clients including soliciting and handling of the clients orders, Mr Smith contends that they have to be looked at in the contents of a very late submission (see paragraph 29) by Mr Chan that there was no evidence of agency and a concern on the part of the Board that if the Taxpayer had not adduced evidence of agency whether it should therefore conclude that there was none. What the Board was saying in those paragraphs Mr Smith argues, is that just because the Taxpayer had not produced direct evidence of agency it was not prepared to conclude that it was unable to produce such evidence. In the latter part of the paragraph 29, the Board was pointing out the situation faced by a Taxpayer in the absence of a procedure for exchange of pleadings. It would not know what was in issue and therefore whether it was sufficient to rely upon an inference of agency from all the circumstances or whether he should support that evidence by direct evidence of agency. The reference to the passage from the Commissioner's Reasons which Mr Thomson had read without demur while in itself it only related to local brokers was simply an example of how a Taxpayer might be led to believe that agency was not seriously in issue. What the Board was saying in paragraph 31 was that from the fact that in most cases the Taxpayer was able to earn commission from its clients through orders placed by clients with overseas offices, the Board considered it right to draw the inference that the Taxpayer engaged the overseas offices as its agents to perform the task of liaising with clients including soliciting and handling of the clients orders. It was not prepared to draw the inference from the absence of direct evidence of agency that the Taxpayer could not call any.

Conclusion regarding the agency of the overseas offices

31. I borne in mind that it is not for this court to reconsider findings of fact made by the Board of Review nor inferences to be drawn from such findings of fact. The role of this court is to consider whether the Board erred in law in its determination.

32. Lord Jauncey of Tullichette in *Richfield International Land and Investment Company Limited v Commission of Inland Revenue* [1989] 3 HKTC 167 summarised the law in this way:

> "A finding of fact by tax commissioners or other similar bodies charged with the hearing of appeals against assessment to tax will only be set aside by an appellate court, whose jurisdiction is restricted to matters of law, if it appears that the body in question has acted without any evidence or upon a view of the facts which could not reasonably be supported (*Edwards v Bairstow* [1956] AC 14, Viscount Simonds at page 29). These principles apply not only to primary facts but to inferences drawn therefrom (*Furniss v Dawson* [1984] AC 474, Lord Brightman at pages 527-8). Furthermore if the primary facts as found are capable of supporting two alternative inferences it is no function of the appellate court to substitute its preferred inference for that legitimately drawn by the body in question (*Furniss v Dawson* supra per Lord Brightman at page 528, *Lim Foo Yong Sdn. Bhd. v Comptroller-General of Inland Revenue* (1986) STC 255, Lord Oliver of Aylmerton at page 259a)."

33. In *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14 at 36 Lord Radcliffe said:

> "When the case comes before the court it is its due to examine the determination having regard to its knowledge of the relevant law. If the case contains anything ex facie which is bad law and which bears upon determination it obviously erroneous in point of law."

34. I have found the resolution of the issue as to whether the Board of Review erred in law in reaching its findings far from easy.

35. I am satisfied that although there was evidence to which Miss Li drew the court's attention to the opposite effect, there was evidence before the Board which *could* have justified a conclusion by the Board that the group's overseas offices were acting as agents of the Taxpayer in liaising with clients, processing, handling and management orders and the provision of primary research material. I do not propose to refer to the evidence in detail but it includes the fact that the overseas clients would sign a client agreement with the Taxpayer as a result of the activities of the overseas offices, that the Taxpayer thereafter accepted responsibility for losses arising from wrongful dealing and that the subsequent documentation in relation to the transaction suggested the client was the client of the Taxpayer.

36. The difficulty arises because of the manner in which the Board has expressed itself in its Conclusions and Reasoning in relation to commission from overseas clients. It reached its conclusion (in paragraph 34) that the profits generated from orders from overseas clients arose substantially from a offshore source on the basis that the group's overseas offices were the Taxpayer's agents in maintaining the relationships with the client, processing, handling and management of the orders and the provision of primary research materials.

37. It had however stated in paragraph 30:

> "The problem remains that we have no evidence of the arrangements between the Taxpayers and the other companies or offices in the group".

On the face of the Case Stated therefore it appears that the Board was saying that it was drawing a conclusion of agency despite an absence of evidence, but that for reasons it gave in paragraph 29 of the Case Stated, it did not consider that the absence of direct evidence indicated that the Taxpayer was unable to produce such evidence.

38. For the Board to have reached such a conclusion in the belief that there was no evidence would be remarkable and I accept Mr Smith's argument that the court should look to see if the Board's reasoning can be read in a way that is rational and reasonable and therefore supportable.

39. It would be possible to do so by inferring that what the Board meant when it said that it had no evidence of arrangements between the Taxpayer and other companies or offices in the group was that it had no direct evidence and to infer that the evidence upon which the court concluded that the overseas offices were the agent of the Taxpayer was contained in the first sentence, paragraph 31:

> "The fact that (apart from orders bought in by W I Carr (America) Limited and W I Carr (Singapore) Limited) the Taxpayer was able, during the relevant years of assessment to earn commission from its clients through orders placed by overseas offices".

40. If matters had stood there, I would have concluded that must have been the way in which the Board reached its conclusion and that it revealed no error of law.

41. The Board however, clearly was concerned about the failure of the Taxpayer to adduce evidence about its arrangements with the overseas offices when the burden of proof under S. 68(4) of the Inland Revenue Ordinance lay upon the Taxpayer to prove that the assessment was erroneous (see paragraph 30). The Board was sufficiently concerned to look for an explanation for the Taxpayer's failure. This was presumably because if there were no explanation for the Taxpayer's failure, it would be open to the Board to conclude that the reason for the failure to call such evidence was that the Taxpayer was unable to do so. The basis upon which the Board found the Taxpayer's failure to call

such evidence was explicable was contained in the passage from the Commissioner's Determination (set out in paragraph 29 of the Case Stated) read out by Mr Thomson for the Taxpayer in his opening submissions without demur from counsel for the Commissioner. It is common ground between counsel before this court that while that passage refers to "agents in the stock exchanges overseas", that reference is to the agents as brokers executing the sale and purchase of securities in overseas markets, not overseas offices acting in the capacity with which we are now concerned. Any failure to demur to this passage by counsel for the Commissioner could not therefore lead to an inference that the Taxpayer believed that the Commissioner was accepting that overseas offices were the Taxpayer's agents in this latter capacity.

42. In the final sentence of paragraph 31 of the Case Stated the Board concluded:

> "In the circumstances we consider it right to draw the inference that the Taxpayer engaged the overseas offices as its agents to perform the task of liaising with clients including soliciting and handling of client's order".

The "circumstances" to which the Board was referring must include the explanation contained in the previous sentence which the Board erroneously concluded provided an explanation for the Taxpayer's failure to adduce evidence of its arrangements with the overseas offices.

43. While this court cannot interfere with a legitimate inference that might have been drawn by the Board, it can interfere when that inference is drawn upon a clear misapprehension as to a matter upon which it drew the inference.

44. I find that is what has happened in this case. I find therefore that the Board did err in law in relation to the matters set out in questions 1 and 3 of the Case Stated. The answer to both those questions is yes.

45. This does not mean to say that the Board could not necessarily reach the same conclusion on a proper reconsideration of the matter. In my view the proper course is to annul the Board's finding that the profits generated by the Taxpayer from orders from overseas clients or overseas markets arose substantially outside Hong Kong and are not chargeable to tax and remit this aspect of the case to the Board for their reconsideration in the light of my opinion.

46. Certain correspondence between the parties has been put before the court. That correspondence took place partly before and shortly after the hearing before the Board of Review. It has been suggested on behalf of the Taxpayer that that led the Taxpayer to conclude that the Commissioner was agreeing not only the facts in the Commissioner's Determination under the heading "Facts upon which the determination was arrived at" but other matters in the Commissioner's Determination. In so far as the correspondence prior to the hearing before the Board is concerned, there was no justification for the Taxpayer to believe that the Commissioner was accepting anything except that which appears under the heading "Facts upon which the determination was

arrived at". In so far as correspondence shortly after the hearing is concerned, I have no reason to doubt what I have been told by Miss Li on instructions, that those acting for the Commissioner still believed that the facts to which the Taxpayer's representative was referring were the facts contained under the heading "Facts upon which the determination was arrived at". If as appears to have been the case that there was some misunderstanding between the parties in this latter part of the correspondence, then that, if necessary, could be the subject of an application to a reconvened Board by the Taxpayer to adduce evidence of any facts contained in the remaining part of the Commissioner's Determination. It would be for the Board to consider the merits of such an application.

Was the actual execution of the orders at the overseas markets the acts of the Taxpayer performed through its agents the brokers?

47. The Board concluded that the actual execution of orders at the overseas markets was not the acts of the Taxpayer performed through its agents the brokers.

48. The Board's reasons for this conclusion are stated in paragraph 32 of the Case Stated. Having concluded that the Taxpayer engaged the overseas offices as its agents to perform the task of liaising with clients including soliciting and handling of the clients orders, it went on:

> "As regards the actual execution of the order, we are not able to draw a similar inference. The orders were executed at the overseas market mostly by local brokers. (Mr Eymery's evidence was that at the relevant time, only the Seoul office had a membership status.) These brokers would have charged their own commission, and there is no evidence or indeed any suggestion that this was in turn charged to the client as a disbursement. These local brokers were thus only engaged by the relevant office as independent contractors in carrying out the orders at the market. For this reason, we do not think that it would be right to regard the actual execution of the order at the market as the act of the Taxpayer."

49. Mr Smith for the Taxpayer attacks this conclusion in a number of ways. He comments with some justification that this conclusion is somewhat surprising in view of the contents of paragraph 29 as the passage read out by Mr Thomson to which Mr Chan for the Commissioner did not demur referred to the local brokers as agents. He says also with some justification that the fact that the local brokers charged their own commission and there was no evidence that this was charged as a disbursement to the client (but that on the contrary the Taxpayer made a profit from the difference between the commission it charged and the customer and the commission it paid the broker), pointed to the stockbrokers being the agent of the Taxpayer rather than the contrary.

50. Mr Smith's principal argument was that the reference to the local brokers being independent contractors was meaningless in the context of the test that must be applied.

51. Mr Smith argued that the local brokers were the agents of the Taxpayer (and he

referred to the description of a broker in paragraph 1-033 *Bowstead on Agency* (16th ed.) as "an agent whose ordinary course of business is to negotiate and make contracts for the sale and purchase of goods and other property of which he is not entrusted with the possession or control"). He submitted that the court does not need to look for a special agency agreement between the Taxpayer and the local office or local broker. The court needs simply to ask whether the acts done overseas were done on behalf of the Taxpayer. The Taxpayer had customers who had placed orders for the buying and selling of shares on overseas markets. The Taxpayer had contracted to accept responsibility for the execution of the transactions. The transaction had subsequently been executed. It followed that someone must have done it on behalf of the Taxpayer. That person was the local broker.

52. Mr Smith referred to a number of other cases, in particular *Commissioner of Income Tax of Bombay Presidency and Aden v Chunilal B Mehta of Bombay* [1938] LR 65 India Appeals 332, the facts of which he suggested were material to the present case. That case concerned a resident of British India who carried on business as a broker in Bombay who made certain profits from contracts made from the purchase and sale of commodities in various foreign markets, such contracts being made through brokers resident abroad and operating in those markets. The question in issue was whether the profits of the trade were profits "accruing or arising in British India", a test not significantly different from that contained in S.14 of the Inland Revenue Ordinance (see Lord Bridge of Harwich in *Commissioner of Inland Revenue v Hang Seng Bank Ltd.* [1991] 1 AC 306, at 332). The court treated the overseas brokers as agents of the Taxpayers for the purpose of executing orders overseas but concluded (page 352) that

> "under the Indian Act a person resident in British India carrying on business there and controlling transaction abroad in the course of such business is not by these mere facts liable to tax on the profits of such transaction".

In the particular circumstances of that case the Privy Council found that the Taxpayers profits did not arise or accrue in British India.

53. Miss Li's response, as I understand it, was that she accepted that the overseas brokers did act as agents in executing the orders on the overseas markets but the question in each case was to determine the agent of whom. She stated that in the cases referred to by Mr Smith, the Taxpayer had been the person placing the orders on his own account with the overseas broker. She suggested that in this case, the overseas broker was or might be the agent of the client rather than the Taxpayer.

54. Having heard counsel's submissions I am satisfied that Mr Smith's analysis is correct in so far as Hong Kong clients are concerned.

55. In so far as those clients are concerned the Board has erred in law in that "it acted without any evidence or upon a view of the facts which could not be reasonably be supported" (*Edwards v Bairstow* [1956] AC 14). All the evidence pointed to the overseas brokers executing the transactions on behalf of the Taxpayer rather than as agent

for the client or indeed any other person. The Taxpayer had contracted with its client to be responsible for the execution of the transactions. It did not pass on the commission it was obliged to pay the local overseas stockbroker as a disbursement but derived its profits from the difference between the commission it charged to the client and the commission it had to pay the local stockbroker. Furthermore the documentation produced in respect of typical transactions before the Board were consistent with the overseas broker acting only on behalf of the Taxpayer.

56. The answer of the court to question 2 posed by the Case Stated is ' yes' in so far as Hong Kong clients are concerned.

57. In so far as overseas client are concerned, the issue as to whether the clients were the clients of the overseas office or the Taxpayer remains open in view of my earlier opinion. The determination of that question may have a bearing on whether the execution of the orders at the overseas markets were the acts of the Taxpayer. That will be a matter for the Board.

Question 4

58. The 4th question for the opinion of the court is related to the 5th question as if apportionment is both permissible and appropriate the question of whether the source of profits generated by the Taxpayer from orders from Hong Kong clients executed on overseas markets was predominantly Hong Kong or that Hong Kong was where the acts more immediately responsible for the receipt of profits were undertaken becomes redundant.

59. Clearly my finding that the execution of the orders from Hong Kong clients on the overseas markets were the acts of the Taxpayer increases the offshore element the source of profits, though it will have to be borne in mind in assessing the source of profits that the Taxpayer was charging his clients much higher fees that a discount brokerage would charge by way of commission reflecting the possibility that the "added value" in having the Taxpayer execute the transaction may well reflect an onshore element to the profits.

Question 5

60. The 5th question of law for the opinion of the court relates to whether the Board of Review was correct in law in deciding that they were not permitted to apportion profits derived from commission from Hong Kong clients.

61. The Board of Review acknowledged that whether the law allowed or required apportionment when the profits arose in or are derived from more than one source both from Hong Kong and from an outside source, was not an easy question.

62. It concluded with reluctance that on the present state of the authorities and despite the opinion of the Judicial Committee of the Privy Council in *Commissioner of*

Inland Revenue v Hang Seng Bank Limited [1990] 1 AC 323, it was bound by the decisions of the Court of Appeal and could not make any apportionment.

63. The decisions of the Court of Appeal to which the Board was referring were *Commissioner of Inland Revenue v The Hong Kong and Whampoa Dock Co. Ltd.* [1960] HKLR 166 and *Commissioner of Inland Revenue v Hang Seng Bank* [1989] 2 HKLR 236.

64. In *Commissioner of Inland Revenue v Whampoa Dock Co. Ltd.* (1960) 1 HKTC 85, Reece J (at p.115) took the view that since S.14 of the Ordinance made no provision for apportionment of profits arising in or derived from Hong Kong and those arising in or derived from elsewhere, the court could not make an apportionment. In circumstances where some profits arose in Hong Kong and some outside Hong Kong, the court adopted a test formulated by Dixon J in *Commissioner of Taxation (New South Wales) and Hillsdon Watts Ltd.* 57 CLR 36, for situation where profits could not be dissected and separate parts attributed to different places, namely that the locality where the profits arose "must be determined by considerations which fasten upon the acts more immediately responsible for the receipt of profits". This was the test used by the court in *Commissioner of Inland Revenue v The Hong Kong and Whampoa Dock Co. Ltd.* which led the court to the conclusion that the profits in that case did not arise in or derive from Hong Kong.

65. When the Court of Appeal came to decide *Commissioner of Inland Revenue v Hang Seng Bank Ltd.* (1989) 2 HKLR 236, it was again the absence of a statutory provision for the apportionment of profits which led the Court of Appeal to decide that apportionment was not possible. At p.243 Cons V-P said:

> "The hypothetical answer foreshadows the next question, <u>for Hong Kong legislation makes no provision for the geographical apportionment of profit.</u> The Board of Review is required to ascribe to it only one location. In *Hong Kong and Whampoa Dock Co. Ltd.* at p.193-4 Reece, J approved the suggestion of Dickson, J in *Commissioner of Taxation (N.S.W.) v Hillsdon Watts Ltd.* (1936) 57 CLR 36 that in the circumstance, i.e. where the profit is derived from more than one location, "the locality where it arises must be determined by considerations which fasten upon the acts more immediately responsible for the receipt of the profit". (There was much argument before us as to whether "immediately" was intended to refer to time or space.) My Lord Clough will prefer a need to identify "a dominant factor or factors". It seems to me that both expressions contemplate the same underlying concept, which is equally to be found in Lord Atkin's use of the words "in substance" in *Smidth v Greenwood*."

66. The Court of Appeal decided that notwithstanding that this case was a multi-source cases (i.e. the profits derived partially from outside Hong Kong and partially from within) it was obliged to look at the "dominant" source.

67. When the case came before the Privy Council (*Commissioner of Inland*

Revenue v Hang Seng Bank [1991] 1 AC 306) the Privy Council took the view that the Court of Appeal had erred in concluding that this was a multi-source case and found that the profits in question derived from a source outside Hong Kong. It is apparent from the report of argument in that case that the Privy Council had heard argument as to the possibility of apportionment. Although it was no longer necessary for their determination in the light of their finding that this was not a multi-source case (and therefore strictly obiter) Lord Bridge of Harwich (at p.323) delivering the unanimous opinion of the Privy Council said:

> "There may, of course, be cases where the gross profits deriving from an individual transaction will have arisen in or derived from different places. Thus, for example, goods sold outside Hong Kong may have been subject to manufacturing and finishing processes which took place partly in Hong Kong and partly overseas. In such a case the absence of a specific provision for apportionment in the Ordinance would not obviate the necessity to apportion the gross profit on sale as having arisen partly in Hong Kong and partly outside Hong Kong. But the present case was a straightforward one where, in their Lordships' judgment, the decision of the Board of Review was fully justified by the primary facts and betrayed no error of law."

68. The reasoning of the Privy Council was therefore that the absence of a specific statutory provision for apportionment did not preclude it.

69. Mr Smith has sought to argue that this court is free to follow the opinion of the Privy Council in this regard because he argues that the dicta in the judgment of the Court of Appeal in *Commissioner of Inland Revenue v The Hong Kong and Whampoa Dock Co. Ltd. and Commissioner of Inland Revenue v Hang Seng Bank Ltd.* were obiter in so far as they ruled that apportionment was not possible in that both were ultimately not multi-source cases.

70. In so far as the Court of Appeal's judgment in *Commissioner of Inland Revenue v Hang Seng Bank Ltd.* Is concerned, I accept Mr Smith's argument to be correct. There can be no doubt that if there had been no appeal from the decision of the Court of Appeal its ruling on apportionment would have been part of the ratio decidendi since the Court of Appeal had concluded that this was a case where profits were "multi-source". However once the Privy Council overturned the Court of Appeal's decision that the profits were multi-source and ruled that the profits were derived entirely from sources offshore, the pronouncements of the Court of Appeal regarding the question of apportionment were relegated to the status of obiter dicta.

71. I accept Miss Li's submissions however that the pronouncement of the Court of Appeal regarding apportionment in *Commissioner of Inland Revenue v The Hong Kong and Whampoa Dock Co. Ltd.* were not obiter dicta. While Reece J (at page 114) did describe the profits arising outside Hong Kong as "very small, infinitesimal perhaps" it is clear from a careful ruling of the judgment that he did regard it as a multi-source case.

72. Is this court therefore bound to follow the Court of Appeal in *Commissioner of Inland Revenue v The Hong Kong and Whampoa Dock Co. Ltd.*? After very careful consideration, I am persuaded by the argument of Mr Smith, with whom Miss Li, for the Commissioner, does not take issue on this point, that I am free to depart from the ruling of the Court of Appeal in *Commissioner of Inland Revenue v The Hong Kong and Whampoa Dock Co. Ltd.* in the light of the dicta of the Privy Council of *Commissioner of Inland Revenue v Hang Seng Bank Ltd.* if I consider it appropriate to do so.

73. Both counsel as I understand them accept that the situation in this case falls within an exception to "Stare Decisis", as explained in *Cross and Harris, Precedent in English Law* (4th ed. Chapter IV). Miss Li would put this case in the category of "implied overruling". Mr Smith puts it in the category of cases where the ratio decidendi of the Court of Appeal in *Commissioner of Inland Revenue v The Hong Kong and Whampoa Dock Co. Ltd.* has been "undermined". The learned authors put the principle in this way:

> "A High Court judge of first instance confronted with a decision of the Court of Appeal which has not been expressly overruled by a later House of Lords' case may cease to be bound by it because the House of Lords considered that the Court of Appeal misinterpreted the authorities on which the impugned decision was based. The judge is then not obliged to follow the Court of Appeal, but he is not bound to dissent from their conclusion. The previous decision is undermined rather than directly overruled."

74. The principle is exemplified by the decision of Hodson J in *Cackett v Cackett* [1950] P 253. There can be no doubt that the principle is not confined to a misinterpretation of authorities but extends to other misinterpretation of the law and indeed perhaps to any reasoning which led to the ratio decidendi of a case decided in a lower court if a superior court has decided that reasoning to be faulty. What the Privy Council did in *Commissioner of Inland Revenue v Hang Seng Bank Ltd.* was impugn the reasoning which led the Court of Appeal to conclude that apportionment was not possible, i.e. because there was no statutory provision for it.

75. Accordingly, in my view, it was open to the Board of Review to apportion profits derived from commission earned from Hong Kong clients from the execution of orders in the overseas markets. In my view, it would be appropriate for them to do so.

76. The court's answer to question 5 is "no".

77. Accordingly, I remit this case to the Board of Review for it to reconsider its conclusion based upon my opinion that it has erred in law in the manner I have described:

> (1) In drawing its conclusion that the Taxpayer engaged overseas offices as its agents in performing various tasks such as the maintenance of the relationship with the client, the processing, handling and management of the orders and the provisions of the primary research materials.

(2) In not, in so far as Hong Kong clients are concerned, concluding that the actual execution of the orders at the overseas markets were the acts of the Taxpayer performed through its agents the brokers.

In so far as overseas clients are concerned, the Board should reconsider its ruling whereby it concluded that the acts of execution of the orders of the overseas markets were not the acts of the Taxpayer in the light of its reconsideration of the evidence of the relationship between the overseas clients and the Taxpayer and in the light of my ruling regarding Hong Kong clients. In so far as Hong Kong clients are concerned, the Board should apportion profits as they consider appropriate in the light of my opinion.

78. In view of my ruling that the apportionment is permissible in law, I grant leave to the parties to have the matter restored in order to argue whether it is possible to amend the Case Stated or otherwise argue that the profits from the orders of overseas clients should be apportioned and whether it would be appropriate to do so.

79. I make the following order nisi to costs unless either party applies to be heard on the question of costs: that the costs occasioned by and related to questions 1 and 3 be borne by the Taxpayer; that the costs occasioned by and related to questions 2, 4 and 5 be paid by the Commissioner.

(P K M Longley)
Deputy High Court Judge

Representation:

Ms Gladys Li, SC, instructed by Department of Justice for Commissioner of Inland Revenue (Appellant in HCIA 5/01 and Respondent in HCIA 4/01)

Mr Clifford Smith, SC, leading Mr Meil Thomson, instructed by Messrs Johnson, Stokes & Master for Respondent in HCIA 5/01 and Appellant in HCIA 4/01