CACV 371/2002

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF APPEAL

CIVIL APPEAL NO. 371 OF 2002
(ON APPEAL FROM HCIA NO.1 OF 2002)

BETWEEN

COMMISSIONER OF INLAND REVENUE Appellant

And

KWONG MILE SERVICES LIMITED Respondent
(IN MEMBERS' VOLUNTARY WINDING UP)

Before: Hon Cheung JA, Ma JA & Seagroatt J in Court
Date of Hearing: 17 & 18 June 2003
Date of Judgment: 20 August 2003

J U D G M E N T

Hon Cheung JA:

The question

1. The question in this appeal is whether the profits arising from an underwriting contract entered between the appellant taxpayer ("the taxpayer") and a developer in Guangzhou in respect of a building ("the building") built by the developer in Guangzhou were subject to Hong Kong tax?

The decisions

2. The Inland Revenue Department assessed that the profits were subject to tax. The Commissioner of Inland Revenue ("the Commissioner") affirmed the assessment. On appeal to the Board of Review ("the Board"), a majority of the Board reversed the determination of the Commissioner. On appeal by way of Case Stated, Deputy High Court Judge Fung allowed the appeal by the Commissioner. The taxpayer now appeals.

The background

3. Without going into details, the background of the transaction is this. The taxpayer carried on business in Hong Kong. It was its intention to make a profit from the development of the building. Instead of directly buying and later selling the building for a profit, the taxpayer chose to underwrite the sale of the building.

4. The underwriting contract was dated 22 November 1991. It was a two-page document and contained six short clauses. By it the taxpayer agreed to underwrite the sale of the units in the building in the sum of $84,314,015.00.

5. The underwriting period was until 30 June 1992. If, on or before that day, the total price the developer received from the sale of the building exceeded $84,314,015.00, then the developer would pay the difference of that amount and $84,314,015.00 to the taxpayer.

6. If, however, the amount was less than the underwritten amount, the taxpayer would have to pay the difference to the developer. It would also have to take up the unsold units.

7. In order to implement the underwriting the taxpayer, through a Hong Kong agent, advertised the building in Hong Kong and secured contracts of sale for the units with purchasers in Hong Kong. The purchasers had to sign in Hong Kong a "pre-contract provisional agreement" with the developer. The taxpayer, also had to arrange for these purchasers to go to Guangzhou to sign a "pre-contract formal agreement" with the developer. The taxpayer was not a party to these agreements.

8. It is a finding of fact by the Board that the acts of the agent were the acts of the taxpayer and the "pre-contract provisional agreements" were binding legal agreements.

9. The sale was extremely successful. The amount arising from the sale exceeded the underwritten sum of $84,314.015.00. The taxpayer was paid by the developer the agreed difference which the Commissioner assessed to be subject to profits tax.

Section 14 of the *Inland Revenue Ordinance*

10. Under section 14 of the *Inland Revenue Ordinance* ("the *Ordinance*") profits tax is charged on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong from such trade, profession or business.

The principles

11. In *Commissioner of Inland Revenue v. Hang Seng Bank Ltd.* [1991] A.C. 306, Lord Bridge of Harwich sitting in the Privy Council held that the three conditions that must be satisfied before a charge to tax can arise under section 14 are:

> " (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," which their Lordships construe to mean from 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."

12. He held that the guiding principle in deciding whether the gross profit resulting from a particular transaction arose in or derived from one place or another is that,

> **"one looks to see what the taxpayer has done to earn the profit in question."**

13. In *Commissioner of Inland Revenue v. HK-TVB International Ltd.* [1992] A.C. 397, Lord Jauncey of Tullichettle further held that Lord Bridge's guiding principle could properly be expanded to read

> **"one looks to see what the taxpayer has done to earn the profit in question and where he has done it."**

14. Lord Jauncey recognized that this expanded principle took into account the earlier judgment of Atkin L.J. in *F.L. Smidth & Co. v. Greenwood* [1921] 3 K.B. 583 when he said that,

> " I think that the question is, where do the operations take place from which the profit in substance arise?"

The principle was not applied

15. The majority of the Board had relied on these two cases in their decision. But if one really applies the guiding principle stated in these two cases to the facts of this case, then the inevitable conclusion is that the majority of the Board had erred in concluding that the profits arose in or was derived from Guangzhou when the taxpayer entered into the underwriting contract with the developer. It wrongly held that the profits of the taxpayer arose from the assumption of the risk in the underwriting.

16. In coming to this view, I do not consider that the majority had misunderstood the nature of the underwriting. They have clearly stated that the risk assumed by the taxpayer was that the total sale proceeds of the building would not exceed the guaranteed sum.

17. What they have gone wrong is that they have taken this underwriting into account to the exclusion of other matters.

18. Obviously the underwriting contract is the foundation from which the taxpayer sought to make a profit eventually from the disposal of the building. However, if the guiding principle is to see what the taxpayer **has done** to earn the profits, then obviously in this case what the taxpayer **had done** to earn the profits was by the promotion and sale of the building in Hong Kong. It is only by these activities that the profits arose. It is through the promotion and subsequent sale by the taxpayer of the units of the building by means of legally binding "pre-sale provisional agreements" entered into in Hong Kong that the taxpayer's profits eventually arose. Put it in another way, without the operations carried out by the taxpayer, the existence of the underwriting contract would be of no use in the generation of the profits.

19. If one is further required to see **where** the taxpayer has done the activities in order to earn the profits, then the answer must be in Hong Kong. As a result the profits were clearly subject to Hong Kong tax.

Exploitation of foreign property

20. Mr. Chua S.C., counsel for taxpayer, referred to the fact that this case was concerned with a property in Guangzhou. Relying on what Lord Bridge had said in *Hang Seng Bank Ltd.*, he argued that the profits arose from where the property was situated.

21. Lord Bridge after stating the guiding principle, referred to a number of examples, one of which is this:

> "But if the profit was earned by the exploitation of property assets as by letting property, lending money or dealing in commodities or securities by buying and

> reselling at a profit, the profit will have arisen in or derived from the place where the property was let, the money was lent or the contracts of purchase and sale were effected."

22. In *HK-TVB International Ltd.*, Lord Jauncey had clearly said that,

> " the examples were never intended to be exhaustive of all situations in which section 14 of the Ordinance might have to be considered. **The proper approach is to ascertain what were the operations which produced the relevant profits and where those operations took place**." (emphasis added)

23. Further, Lord Nolan said in *Commissioner of Inland Revenue v. Orion Caribbean Ltd.* [1997] HKLRD 924,

> " ... the ascertaining of the actual some of income is a 'practical hard fact' ... No simple, single legal test can be employed."

24. In my view, the example of exploitation of a foreign property given by Lord Bridge only highlights the application of the guiding principle. If the profits arise from the buying and selling of a foreign property that has taken place overseas then it means the operation from which the profits arise takes place in a foreign country. It does not mean that the situation or location of a property will necessarily determine where the profits arise.

25. Likewise in relation to the present case the fact that the building was situated in Guangzhou was not the determinative factor. It was the operation of the taxpayer in Hong Kong which generated the profits.

Finding of fact?

26. Mr. Chua relying on the well-known case of *Edwards v. Bairstow* [1956] A.C. 14, further argued that the majority of the Board had committed no error of law. He argued that they had not chosen to rely on the underwriting contract to the exclusion of other factors. They had weighed up all the relevant factors and chosen to rely on the underlying contract. As such the court should not interfere with the decision which was a decision on facts because the test is not whether the decision is wrong but whether it is so unreasonable or perverse that no reasonable person could reasonably make it.

27. It is apparent from the Case Stated that the majority were not merely weighing up all the factors and coming to a decision that a reasonable person could arrive at on the facts of the case. The matter can be approached like this. By relying on the underwriting contract and holding that the promotion and sale done by the taxpayer were irrelevant (the words they used were "not directly relevant"), they had not really considered what the **taxpayer had done** and **where** it had

done it to generate the profits. There is a clear error of law. In other words they had not applied the guiding principle at all. To say that the taxpayer was not contractually obliged to market and sell does not answer the question because it was only through these operations that the profits arose.

Other matters

28. Mr. Chua, in his customary diligence, had advanced detailed arguments and relied on many authorities in support of his case. I have, however, focused on what I considered to be the essential and core matter which is determinative of the appeal.

Conclusion

29. The judge was correct to reverse the majority decision of the Board. I would dismiss the appeal.

Hon Ma JA:

30. I agree.

The Facts

31. By a Determination of the Commissioner of Inland Revenue ("the Commissioner") dated 30 November 1998 made pursuant to section 64(4) of the Inland Revenue Ordinance, Cap.112 ("the Ordinance"), a profits tax assessment totalling $6,860,124 for the four tax years from 1992/1993 to 1995/1996 was confirmed against the taxpayer, Kwong Mile Services Limited (a company now in voluntary liquidation) ("the Taxpayer"). The Taxpayer appealed to the Board of Review against the Determination pursuant to section 66 of the Ordinance.

32. In a decision dated 29 May 2001, the Board of Review, by a majority, allowed the Taxpayer's appeal. The dissenting member was Mr Mohan Bharwaney, to whose opinion I shall refer further below. By a Case Stated dated 4 January 2002 made pursuant to section 69 of the Ordinance, the following questions of law were referred to the Court of First Instance for its opinion:

> " Whether, having regard to all the facts as found by the Board of Review, and on the true construction of Cap.112 in particular s.14 thereof, the majority of the Board of Review:
>
> (a) was correct in law in holding that the profits of the Taxpayer arose in and derived from the assumption of an underwritten risk which was outside Hong Kong; and

(b) erred in law in concluding that the more potent factor to give weight to in deciding the source of the Taxpayer's profits was the assumption of risk in China and not the marketing and sales activities (including the receipt of purchase price) by the Taxpayer in Hong Kong."

33. In a judgment handed down on 29 July 2002, Deputy High Court Judge Fung held that the decision of the majority in the Board of Review could not be sustained and answered the two said questions "No" and "Yes" respectively.

34. The Taxpayer now appeals to this court by a Notice of Appeal dated 26 September 2002. After hearing submissions from Mr Chua Guan Hock SC (with him, Mr Jonathan Chang), we did not call on Mr Ambrose Ho SC (who was assisted by Mr Stewart Wong). Although we did not dismiss the appeal at that time, it is clear this was the only outcome and I would formally do so now. Before dealing with the issues arising in this appeal, however, I first set out the facts germane to the present case.

35. The essential facts (as contained in the Case Stated) were these:

(1) The Taxpayer was incorporated in Hong Kong on 2 May 1991. Its principal (if not only) business, as described in its profits tax return, was stated to be an "underwriter" of real estate development in the PRC and the development and sales of properties.

(2) The relevant property development in the present case was a residential and commercial development called Regent House located at 50, Tao Jin Lu, in Guangzhou. The developer of Regent House was South House Property Industry Co Ltd ("South House"), a Guangzhou based property developer.

(3) On 22 November 1991, an underwriting agreement in Chinese ("the Underwriting Agreement") was made in Guangzhou between South House and the Taxpayer relating to the residential units from the 4th to 25th floors (excluding the 13th floor) at Block 4 of Regent House and some car park spaces ("the Property"). At this time, the Regent House development was still uncompleted (it was not completed until late 1994).

(4) The Underwriting Agreement provided that the Taxpayer was to underwrite to the extent of HK$84,314,015 and for a period ending on 30 June 1992, the sale of the Property. Essentially, the obligation on the Taxpayer was to pay South House the said sum irrespective of whether or not all the units in the Property were sold by that date and regardless of the purchase prices obtained for them. If the total sales for the units in the Property did not reach

$84,314,015 by 30 June 1992, the Taxpayer was obliged to pay South House the difference. Correspondingly, if the purchase price for the Property exceeded the said sum, the excess would belong to the Taxpayer. All payments were to be made in Hong Kong in Hong Kong dollars.

(5) The uncompleted units comprised in the Property were intended to be sold to Hong Kong buyers. The marketing and sales of the Property in Hong Kong were undertaken by the Taxpayer. For this purpose, by a letter dated 23 November 1991, the Taxpayer appointed Canada Land Ltd (a Hong Kong company which on 28 July 1994 acquired the shares in the Taxpayer) ("Canada Land") as its exclusive agent in marketing and selling the Property in Hong Kong. Canada Land was also appointed the project manager for the Property in December 1993.

(6) The marketing and sales of the Property in Hong Kong took place from December 1991 through to March 1992, with the majority of the sales taking place in January 1992. All but two of the buyers of the units of the Property were Hong Kong residents and payments were made in Hong Kong also in Hong Kong dollars.

(7) In purchasing units in the Property, the Hong Kong buyers would first make provisional sale and purchase agreements in Hong Kong. These agreements were stated to be made between them as purchasers and South House as the vendor (through Canada Land). The Board of Review took the view that the provisional sale and purchase agreements were legally binding and enforceable in Hong Kong even though formal sale and purchase agreements were later executed in Guangzhou.

36. Profits accruing to the Taxpayer in relation to the Property following these marketing and sales activities in Hong Kong, the question then was whether the Taxpayer was liable to pay profits tax on these profits. This was the question that the Board of Review had to resolve.

The Decision of the Board of Review

37. In the proceedings before the Board of Review, it was accepted by the Taxpayer that it carried on business in Hong Kong and it made profits from its business.

38. Two issues however divided the parties:

(1) The nature of the Underwriting Agreement: whether the Taxpayer was a property trader who had acquired an interest in the Property under the Agreement or was only an underwriter in relation to the sale of the Property.

The Taxpayer sought to argue that it was a trader of foreign property and that accordingly no Hong Kong tax was payable.

(2) Irrespective of the nature of the transaction contained in the Underwriting Agreement, whether the profits made from sales of the units in the Property in Hong Kong accruing to the Taxpayer, were taxable.

39. On the first issue, the Board of Review held against the Taxpayer. The Board of Review said this (all three members concurred here):

> " Insofar as the 1st issue is concerned, we make the following findings. The Taxpayer was formed with the purpose of profiting from the Property and its redevelopment. The intention was to acquire an interest at an agreed price from the Developer prior to completion of the construction of the Property and to profit in the sale of the uncompleted individual units. There may have been a consideration of a straight forward purchase and resale, but at the end of the day, the manner in which the Taxpayer chose to realize its intention was the underwriting arrangement."

40. There was no challenge to the Board's findings before Deputy Judge Fung in relation to this issue and accordingly it is not before us. The point of significance, however, is the finding by the Board of Review that the Taxpayer was formed for the purpose of profiting from the Property and its redevelopment. This was presumably why the learned judge referred to the Taxpayer as being a "special purpose company set up wholly for the underwriting of the sale of the Property".

41. The second issue involved more closely the application of section 14(1) of the Ordinance. That section reads as follows:

> " (1) Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part."

Included in the term "profits arising in or derived from Hong Kong" are all profits from business transacted in Hong Kong whether directly or through an agent (see the definitions contained in section 2 of the Ordinance). The role of Canada Land has therefore to be seen in this light.

42. On this issue, the majority of the Board of Review was of the view that the relevant profits did not arise in or derived from Hong Kong. They took the view that the Taxpayer's business was in underwriting (meaning the acceptance of risk in return for a reward) and that in the circumstances of the case, this assumption of risk on the part of the Taxpayer took place in

Guangzhou where the Underwriting Agreement was negotiated and executed. Moreover, the subject matter of the Underwriting Agreement (namely the Property) was located in Guangzhou. As for the marketing and sales activities that took place in Hong Kong, they were regarded by the majority as having taken place after the assumption of risk by the Taxpayer and therefore subsequent to the very activity (namely the underwriting in Guangzhou) that produced the relevant reward or profits. Accordingly, section 14(1) was not applicable to render the Taxpayer liable to profits tax.

43. Mr Mohan Bharwaney, in a dissenting opinion, took a contrary view. While accepting that the origin of the profits was Guangzhou (meaning that the Underwriting Agreement was made there), he nevertheless concluded that profits were made "only because" of the marketing and sales of the units in the Property in Hong Kong. It was the latter aspect that provided the more potent factor in the generation of profits. Accordingly, for his part, Mr Bharwaney was of the view that the relevant profits arose in or derived from Hong Kong and that section 14(1) was engaged.

44. He also had this to say regarding the majority's view in relation to the Hong Kong activities and sales (to which I have made reference in paragraph 42 above):

> " (5) I do not think that the liability-quantum dichotomy helps to solve the problem for the reason that, in my view, the profits did not arise when the underwriting arrangement was entered into, but only when the third party users agreed to purchase the units. Until then, there was a liability which had been undertaken in order to acquire 'contractual rights' which were 'marketable'. It is only when those rights were marketed that the profit was created. As the marketing took place in Hong Kong, therefore, the profit arose in Hong Kong.
>
> ...
>
> (9) The distinction and tug of war, as I see it, is between the source of the marketable product/asset/contractual rights: Chinese product/asset/contractual rights located in China and/or liability arising from its acquisition arising in China; and the source of the profits: Chinese product/asset/contractual rights marketed in Hong Kong and paid for in Hong Kong."

45. The majority decision was one that was reached after "much agony" (see paragraph 78(13) of the Case Stated). It was based predominantly (if not wholly) on the fact that the assumption of risk (analyzed by the majority to be the Taxpayer's business) took place in Guangzhou. It was, however, accepted that if the focus was instead on where the profits materialized, then, like Mr Bharwaney, the majority would have held that profits tax was payable. In this context, the majority said this in paragraph 78(16) of the Case Stated:

> " In other words, if we were to shift ... our focus on the 2nd issue, the place where the profits materialized (rather than the place of assumption of risk) [this] could be argued to be the place where that risk was turned into profit. If we were to treat materialization as the more potent factor, then due to the marketing and sale activities of the Taxpayer in Hong Kong, we would have concluded that the source of the profits was Hong Kong and not China, notwithstanding obvious links to China; in short, the more potent acts to produce the profits occurred in Hong Kong."

The decision of Deputy High Court Judge Fung

46. There were two issues before the learned judge below:

(1) Whether the majority decision of the Board of Review on the second issue before it was correct.

(2) Whether it was in any event open to the Commissioner to challenge the majority decision, it being contended by the Taxpayer that there could be no appeal by way of Case Stated on findings of fact. Reliance was placed here on the principles established in *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14.

47. In allowing the Commissioner's appeal on the issue set out in paragraph 46(1) above, Deputy Judge Fung, as did the Board of Review, referred to a number of authorities on section 14(1) of the Ordinance, among them *Commissioner of Inland Revenue v Hang Seng Bank Ltd* [1991] 1 AC 306, *Commissioner of Inland Revenue v HK-TVB International Ltd* [1992] 2 AC 397 and *Commissioner of Inland Revenue v Orion Caribbean Ltd (in voluntary liquidation)* [1997] HKLRD 924. The learned judge was of the view that at the time the Underwriting Agreement was made, no profits were produced. Profits were only produced when the units comprised in the Property were marketed and sold in Hong Kong. Accordingly, the relevant profits arose in or derived from Hong Kong. The learned judge noted that even the majority of the Board of Review recognized that the assumption of risk in Guangzhou by the Taxpayer only materialized into profits because of the marketing activities and sales in Hong Kong.

48. The learned judge concluded that the majority of the Board of Review erred in holding that the relevant profits arose from the assumption of risk in Guangzhou and not from the activities in Hong Kong. This, according to Deputy Judge Fung, was an error of law. The *Edwards v Bairstow* issue was therefore resolved in favour of the Commissioner.

The issues in this appeal

49. In my judgment, for the reasons that follow presently, the learned judge was right in his conclusion on the two issues before him. The same two issues were argued by Mr Chua before us. They can be articulated in the following way:

(1) Did the relevant profits arise in or derive from Hong Kong? **(Issue One)**

(2) However, is the above Issue One that could be raised by the Commissioner in the first place under the Case Stated procedure contained in section 69 of the Ordinance, by reason of Edwards v Bairstow? **(Issue Two)**

50. Before dealing with these issues, I first deal with the applicable law.

Law

51. I have already set out section 14(1) of the Ordinance in paragraph 41 above. That section has been the focus of several authorities at the highest levels and I have already made reference to them in paragraph 47 above.

52. In *Hang Seng Bank*, the Judicial Committee of the Privy Council had to apply section 14(1) in the context of the investment activities of a Hong Kong bank in the purchase and sale of certificates of deposit, bonds and gilt edged securities. Both the purchase and sale of these financial instruments (which resulted in the profits being made) took place outside Hong Kong (in London and Singapore). It was held that the relevant profits were made as a result of activities that took place outside Hong Kong even though the decision to buy or sell the instruments in question were made in Hong Kong. Accordingly, section 14(1) was not engaged.

53. The following principles regarding section 14(1) of the Ordinance emerge from the judgment of Lord Bridge of Harwich in that case:

(1) It is not enough for the purposes of section 14(1) merely to find the existence of profits which have been made by a business carried on in Hong Kong. It does not follow that such profits arose in or were derived from Hong Kong. Thus, for example, the fact that a company carries on business in Hong Kong (as many Hong Kong companies do) does not mean automatically that all its profits become liable to profits tax. One must go further to inquire whether the relevant profits actually arose in or were derived from Hong Kong. These are the very words found in section 14(1) as well as other related parts of the Ordinance such as section 15 and also rule 2A of the Inland Revenue Rules.

(2) Lord Bridge analyzed section 14(1) in the following way (at 318-F):

> " Three conditions must be satisfied before a charge to tax can arise under section 14: (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,' which their Lordships construe to mean from 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. Thus the structure of the section presupposes that the profits of a business carried on in Hong Kong may accrue from different sources, some located within Hong Kong, others overseas. The former are taxable, the latter are not."

(3) The determination of whether or not profits arise in or are derived from Hong Kong is ultimately a question of fact depending on the nature of the relevant transactions: see 322H(4). However, the "broad guiding principle" is that one must look to see what the taxpayer has done to earn the relevant profits: see 322H-323A.

(4) To summarise then, apart from the basic requirements that the taxpayer must carry on a trade, profession or business in Hong Kong and that profits are made from such activities, section 14(1) also requires that the relevant profits must have arisen from activities or operations carried on by the taxpayer in Hong Kong. This last requirement follows from the words in section 14(1), "assessable profits arising in or deriving from Hong Kong".

54. In *TVB*, section 14(1) was revisited by the Privy Council, this time in relation to the granting by the taxpayer in that case of sub-licences for the exhibition abroad of Chinese films, the rights to which were acquired in Hong Kong. These sub-licences were on the whole negotiated and granted abroad, with representatives of the Hong Kong taxpayer having been sent abroad to solicit business. The Privy Council held on the facts that the taxpayer was liable for profits tax on the basis that the profits in that case derived from the exploitation of film rights and this was an activity that was carried out in Hong Kong.

55. Lord Jauncey of Tullichettle delivered the judgment of the Privy Council. He dealt with the third requirement of section 14(1) (I have already set out the three requirements articulated by Lord Bridge in the *Hang Seng Bank* case in paragraph 53(2) above) in the following way:

(1) The test to determine on the facts of any given case how and where profits have arisen or are derived is to discover "what the taxpayer has done to earn the profits in question and where he has done it": see 407C-D.

(2) The test referred to in the previous sub-paragraph can also be put another way, this time by reference to a part of Atkin LJ's judgment in *FL Smidth & Co v Greenwood* [1921] 3 KB 583, at 593, "I think that the question is,

> where do the operations take place from which the profits in substance arise?" See here: *TVB* at 407C and 409E-F.

56. The "operations test" set out in the previous paragraph provides in my view, a workable guide in determining on any given set of facts the third requirement of section 14(1). That has been the common understanding since the *TVB* case and remains the position today. I do not understand Mr Chua to be saying otherwise.

57. Rather, what Mr Chua submitted essentially, if I have correctly understood his arguments, was that even though certain activities may have taken place in Hong Kong but for which the profits in question would not have been made (such as payments being made here) it did not follow that the third requirement was fulfilled and that therefore the profits arose in or derived from Hong Kong. A number of authorities were cited to us precisely making this point, among them *Commissioner of Inland Revenue v Magna Industrial Co Ltd* [1997] HKLRD 173, at 178G-H. I accept the proposition as far as it goes but providing that one bears in mind at all times the basic approach to the factual inquiry to be carried out, as discussed in cases like *Hang Seng Bank* and *TVB*. Those cases require the taking into consideration of all factors that will assist in the determination of whether the profits concerned have arisen in or are derived from Hong Kong. While I fully accept that certain factors may be irrelevant in some cases (as Mr Chua has tried to illustrate), it must equally be recognized that they may be extremely relevant in others. It is all part of the factual analysis that has to be undertaken.

58. I now turn to the applicable law in relation to Issue Two. The point here to be borne in mind is that in the Case Stated procedure provided by section 69 of the Ordinance, appeals to the court can only be entertained in connection with points of law. There can be no appeal based on findings of facts, unless the relevant finding is so erroneous that no person acting judicially or properly aware of the applicable law could have made such a finding. Included in this latter category are findings where no evidence exists to justify them. In *Edwards v Bairstow*, in a passage commonly quoted, Lord Radcliffe said this at 35-36:

> "But it seemed to be desirable to say this much, having regard to what appears in the judgments in the courts below as to a possible divergence of principle between the English and Scottish courts. I think that the true position of the court in all these cases can be shortly stated. If a party to a hearing before commissioners expresses dissatisfaction with their determination as being erroneous in point of law, it is for them to state a case and in the body of it to set out the facts that they have found as well as their determination. I do not think that inferences drawn from other facts are incapable of being themselves findings of fact, although there is value in the distinction between primary facts and inferences drawn from them. When the case comes before the court it is its duty 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 the determination, it is, obviously, erroneous in point of

> law. But, without any such misconception appearing ex facie, it may be that the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. In those circumstances, too, the court must intervene. It has no option but to assume that there has been some misconception of the law and that this has been responsible for the determination. So there, too, there has been error in point of law. I do not think that it much matters whether this state of affairs is described as one in which there is no evidence to support the determination or as one in which the evidence is inconsistent with and contradictory of the determination, or as one in which the true and only reasonable conclusion contradicts the determination. Rightly understood, each phrase propounds the same test. For my part, I prefer the last of the three, since I think that it is rather misleading to speak of there being no evidence to support a conclusion when in cases such as these many of the facts are likely to be neutral in themselves, and only to take their colour from the combination of circumstances in which they are found to occur."

59. With the above principles in mind, I now deal with the two issues I have earlier set out.

Issue One

60. The relevant profits in the present case comprised the money that the Taxpayer obtained in excess of the $84,314,015 stipulated in the Underwriting Agreement.

61. Before the Board of Review, there was no dispute that the first and second requirements laid down by Lord Bridge in *Hang Seng Bank* (see paragraph 53(2) above) were fulfilled. The dispute was whether the third requirement, as to whether the relevant profits arose in or derived from Hong Kong, was also met.

62. In the application of the relevant test referred to earlier, the first stage is to ascertain what the Taxpayer has in substance done in the present case to earn the profits in question.

63. Here, the following facts emerge from the findings made by the Board of Review, which I have earlier set out:

(1) The profits in question were directly made by the Taxpayer following its marketing and sales activities (through its agent Canada Land) in Hong Kong.

(2) These activities were almost the only business activities carried out by the Taxpayer. It will be recalled that the Taxpayer described its principal business as including the sale of properties. It also described its principal business as being that of an underwriter of real estate development. The term "underwriter" does not in this context mean an insurer or, say, an underwriter

in relation to a subscription of shares. The business of underwriting carried on by the Taxpayer in this case was the guarantee of a specific sum to a property developer in relation to some real estate, but with the onus on the Taxpayer to sell the property in question. The Taxpayer's remuneration under the Underwriting Agreement consisted not of a premium or percentage of the underwritten amount, but the excess over the sum of $84,314,015. This excess, however, could only materialize through the Taxpayer's efforts in selling the Property to buyers in Hong Kong. In this context, it is to be noted that the Taxpayer had the exclusive right to market and sell the Property and to determine the prices at which the units were to be sold.

(3) I accept that the Taxpayer also carried out some activities and incurred certain expenses in Guangzhou in relation to the Property, but in my view, it can hardly be said the relevant profits were attributable to any operations that the Taxpayer may have carried out there. This was a point raised by Mr Chua in his submissions but was not a factor that the Board of Review took into account in its decision.

(4) I acknowledge of course that the profits made by the Taxpayer would not have been made but for the Underwriting Agreement made in Guangzhou. However, it was not the making of that Agreement that earned the profits for the Taxpayer. The profits were made through the marketing and sales activities which the Taxpayer carried out in Hong Kong. The Underwriting Agreement did not so much make the profits for the Taxpayer as merely gave it the opportunity to carry out the sales activities that did. In other words, it was incidental to the operations that actually made the profits. Some analogies might serve to make good the point. A contract for services to be performed in Hong Kong may be made in or outside of Hong Kong, but it is not that contract that enables a person to make profits or earn the money which may be liable to be taxed. Rather, it is the performance of those services that enables the profits or salary to be made. The same can be said for a contract made abroad for goods which are manufactured in Hong Kong. No doubt without that contract, no profits can be made. However, even if payment under that contract is required to be made abroad and not Hong Kong, profits tax would be chargeable since any profits would have been made as a result of the goods having been manufactured here. See here also: *TVB* at 410F-G.

(5) In any event, it will be remembered that under the Underwriting Agreement, all payments were to be made in Hong Kong.

64. The next stage of the test propounded in *Hang Seng Bank* and *TVB* is to ascertain where the Taxpayer has performed those activities that have led to the profits being made. It is clear from the above facts that this took place in Hong Kong.

65. Mr Chua submitted that considerable weight should be given to the fact that the Property, being immovable property, was located in Guangzhou. He sought to rely on certain passages in *Hang Seng Bank* and *TVB* to the effect that where the sale or letting of foreign immovable property was concerned, the operation or activity that has led to any profits being made is generally treated to have taken place at the location of the property. He also referred to *Liquidator, Rhodesia Metals Ltd (In Liquidation) v Commissioner of Taxes* [1940] AC 774. I have not found the passages in *Hang Seng Bank* and *TVB* helpful. Quite apart from the fact that neither of the two cases dealt specifically with immovable property, these passages in any event relate only to the sale or letting of foreign immovable property owned by the taxpayer. That is not the position in the present case (where the Property was owned by South House). This was the very point made by the Privy Council in *Orion Caribbean* at 931C-D. Where the property concerned is not owned by the taxpayer, who, say, is merely an agent arranging the leasing or sale of foreign property on behalf of the real owner, then the taxpayer's profits will be taxable if they are derived from activities in Hong Kong: see *Willoughby, Halkyard & Leung: Encyclopaedia of Hong Kong Taxation* Vol.3 at paragraph 6754. As for the case of *Liquidator, Rhodesia Metals Ltd v Commissioner of Taxes*, this was a case that ultimately depended on its own facts. In that case, not only was the land in question located abroad but the usage or development of it that led to the relevant profits being made, were similarly carried out abroad.

66. For the above reasons, I am of the view that all three of the requirements set out by Lord Bridge in *Hang Seng Bank* are met in the present case and accordingly the Taxpayer is liable to pay profits tax. The conclusion reached by the learned judge below and by Mr Bharwaney in the Board of Review are therefore to be upheld.

Issue Two

67. However, is the conclusion I have just reached in relation to Issue One, open to the court under the Case Stated procedure adopted in the present case? Mr Chua submits not by reason of *Edwards v Bairstow*.

68. I need not dwell at length on this issue. The majority of the Board of Review proceeded on the basis that the relevant activity that led to the profits being made was underwriting, meaning the assumption of a risk for reward. As the Underwriting Agreement was made in Guangzhou, they therefore held that the relevant profits did not arise in or derive from Hong Kong. No consideration, however, was given to the marketing and sales that took place in Hong Kong as these activities were said to have taken place subsequent to the assumption of risk.

69. In my view, although the majority decision did refer to both the *Hang Seng Bank* and *TVB* cases, the applicable principles were not applied or if they were, they were wrongly applied. The majority's focus was on the Underwriting Agreement having been made in Guangzhou and on analysis, the view taken by the majority was simply that without the Agreement, no profits would have been made. Yet, as the authorities demonstrate, this is not the criterion. The mere making of an agreement does not mean that this is the relevant activity carried out by the taxpayer that has earned the profits. Admittedly, it provides the opportunity for the profit to be made (just like the contracts referred to in the examples I have given in paragraph 63(4) above), but it is not (or not necessarily) the activity that earns the profit.

70. The majority of the Board of Review ignored the marketing and sales activities in Hong Kong. In my view, there was no basis to do so. It was said that these activities took place subsequent to the Underwriting Agreement and therefore subsequent to the activities that earned the profits. I am not convinced by either the logic or reason of this. The alternative analysis by the majority (set out in paragraph 45 above) and that of Mr Bharwaney were in my view correct.

71. In these circumstances, it was open to the Commissioner to bring an appeal on a Case Stated. The majority of the Board of Review had erred on a point of law and not just fact. Alternatively, the majority of the Board of Review took a view of the facts that cannot reasonably be supported: see *Richfield International Land and Investment Co Ltd v Inland Revenue Commissioner* (1989) STC 820, at 824f-h. Deputy Judge Fung was right to deal with this aspect as he did.

Conclusion

72. For the above reasons, I would dismiss Kwong Mile's appeal. I would also make an order nisi that Kwong Mile pays the Commissioner's costs of this appeal, such costs to be taxed if not agreed.

73. It only remains for me to thank counsel on both sides for their assistance in this appeal.

Hon Seagroatt J:

74. I agree with the judgments of my Lords, Ma CJHC and Cheung JA and add only this: Whatever the justification or otherwise for describing the agreement in China as an Underwriting Agreement, such a description is inaccurate as far as Hong Kong is concerned. For the taxpayer to describe its business in Hong Kong in relation to this property as underwriting is entirely misleading. The nature of the business is the straightforward common and garden one of property sale or estate agency. The profits from that business arose in Hong Kong. No doubt such a business with its varying aspects can be described more alluringly in other ways, but whatever term is used cannot conceal its true nature.

(Geoffrey Ma)	(Peter Cheung)	(Conrad Seagroatt)
Chief Judge, High Court	Justice of Appeal	Judge of the Court of First Instance

Representation:

Mr Chua Guan Hock SC and Mr Jonathan T Y Chang instructed by Messrs Fred Kan & Co for the Respondent/Appellant.

Mr Ambrose Ho SC and Mr Stewart K M Wong instructed by the Department of Justice for the Appellant/Respondent.