HCIA2/2004

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

INLAND REVENUE APPEAL NO.2 OF 2004

BETWEEN

LAM SOON TRADEMARK LIMITED Appellant

and

THE COMMISSIONER OF INLAND REVENUE Respondent

Before: Hon Tang J in Court
Date of Hearing: 21 July 2004
Date of Judgment: 6 August 2004

J U D G M E N T

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1. This is an appeal by way of Case Stated by the appellant against the Board of Review's confirmation of the Commissioner's additional tax assessments for the years of assessment 1990/1991 to 1993/1994 both inclusive, in respect of the royalty income derived by the appellant from licensing the use of trademarks to its related companies.

2. The appellant is part of the well-known Lam Soon Group of Companies. It was incorporated in December 1987 in the Cook Islands with an issued and paid up capital of US$2. Between December 1987 and October 1990, the appellant was a subsidiary of Lam Soon Hong Kong Limited ("LSHK"). In October 1990, it became a subsidiary of Lam Soon Food Industries (BVI) Limited ("LSF-BVI"). LSF-BVI was in turn wholly-owned by Lam Soon Food Industries Limited ("LSFI"). LSFI became a listed company in Hong Kong in July 1991. LSFI was incorporated in Bermuda and in turn was a subsidiary of LSHK. LSHK was incorporated on 13 May 1961 and is also listed in Hong Kong. Some of its brand names, such as "Knife" and "Axe" are well-known in Hong Kong.

3. As the Board has held and it is uncontroversial "At all relevant times, the principal activities of the Appellant were the acquisition of trademarks and the granting of licences to use the trademarks in return for royalty income." Para. 8(a) (all references are to paragraphs in the Case Stated unless otherwise stated).

4. The appellant had directors in Singapore, Hong Kong and the Cook Islands. One of the directors, Mr T.C. Whang resided in Singapore and he held a controlling interest in the Lam Soon Group. There were two Hong Kong directors, Mr Raymond Ch'ien Kuo Fung, the son-in-law of Mr T.C. Whang, and Mr Stephen Chung Kong Fei. Mr Chung together with Mr Ch'ien were part of the management of LSHK since the 1980s.

5. It was as a result of a management meeting held in Hong Kong on 26 October 1987 between Mr Ch'ien, Mr Chung and Mr K.C. Ho ("Mr Ho") that it was decided that LSHK's trademarks should be transferred to an off-shore subsidiary to be incorporated. Mr Ho was a witness before the Board. That off-shore subsidiary was the appellant.

6. The appellant was used to acquire and hold trademarks. It is accepted that the activities which generated the profits, the subject of the assessments, were the licensing of such trademarks. Thus, when "one looks to see what the taxpayer has done to earn the profit in question and where he has done it", *per* Lord Jauncey in *CIR v HK-TVB 3*, HKTC 468, there is no dispute that it was the licensing of the trademarks which earned the profits in question.

7. The critical issues in this appeal were "who did it?" and "where was it done?".

8. I posed those questions to Mr Thomson for the appellant. He was unable to say who negotiated or agreed the licences on behalf of the appellant nor where they were done, but he relied on the fact that the licence agreements were signed by the corporate directors of the appellant in the Cook Islands.

9. At para. 36, the Board referred to the correspondence between the appellant and the Revenue:

> "Wherein the appellant submitted 'Because of the high turnover rate of management personnel, it is not clear where the negotiation between the licensor and the licensee on the establishment of the agreement took place. Given that the executives of both [the appellant] and [Lam Soon Marketing] were on frequent business travels during the majority period of the years in question, the negotiation process would have been taken place outside Hong Kong'. The Board observed there no evidence had been adduced by the appellant to support these assertions."

10. The Board then went on to find that "the weight of evidence indicates that the likelihood is that the negotiations leading to the agreements all took place in Hong Kong:

> "(a) The appellant and Lam Soon Marketing were part of the Lam Soon Group. At all material times, Lam Soon Hong Kong as their controlling company was a company listed in Hong Kong. The appellant made extensive use of the Cheung Yue Street Office.
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> (b) Both the appellant and Lam Soon Marketing shared the same address at the Cheung Yue Street Office. The Board was of the view that it was unlikely for executives of these companies to travel abroad to discuss issues of common interest.
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> (c) The Board found that the Cook Islands directors were no more than nominee directors acting on instructions. None of them attended the physical meeting which took place in Hong Kong on 11 October 1990. None of them participated in the telephone conference held on 4 March 1993. Whilst T.C. Whang held a controlling interest in Lam Soon Hong Kong, there was no evidence indicating any instruction emanating from him nor was there any evidence of directors' meeting of the appellant being held in Singapore. According to the statement of Mr Ho, Mr Ch'ien and Mr Chung joined the group in the 1980's and "headed the management team". The initial proposal of Mr Chung was considered at a meeting on 26 October 1987 attended by Mr Ch'ien, Mr Ho, Mr Chung and no others. The Board was of the view that they continued to be the moving force behind the various acquisitions and grants. All of them were based in Hong Kong and it was reasonable in these circumstances to infer that Mr Chung signed in Hong Kong the agreements drafted by Lam Soon Management in Hong Kong."

11. The only witness who gave evidence on behalf of the appellant was Mr Ho, and in para. 22 the Board said:

> "The Board was not impressed by Mr Ho. The Board was of the view that Mr Ho was obviously concerned to minimise the association between the Appellant and

Hong Kong and to diminish the roles played by Mr Ch'ien and Mr Chung in the affairs of the Appellant. The Board did not accept Mr Ho's denial of knowledge of the negotiations leading to the various licence agreements."

12. On such evidence, the Board concluded:

"31. The Board held that the Appellant did carry on a business in Hong Kong. The Board was of the view that the Appellant had an office address in Hong Kong. Directors' meetings were held in that office address. Its directors resolved in Hong Kong to acquire the Vecorn and the Fat trademarks registered in Hong Kong. Its directors further resolved in Hong Kong to grant a licence in respect of those trademarks. The instructions given by Ms Li and Ms Leung to solicitors in Hong Kong were part of the activities conducted in Hong Kong on the Appellant's behalf. The payments approved by Mr Ho in Hong Kong were part of such activities.

.....

41. The Board was of the opinion that no question of apportionment arose in this case. The effective decision to acquire the trademarks and to grant licences in respect of the trademarks were all made in Hong Kong. The trademarks were registered in Hong Kong and the protective steps were all traceable to directions from Hong Kong. Hong Kong was the only realistic source."

13. The above two paragraphs should be read together with para. 36(c) quoted above, where it said:

"The Board was of the view that they (Messrs Ch'ien and Chung) continued to be the moving force behind the various acquisitions and grants."

14. The conclusion of the Board that the negotiations for and the agreements to grant the licences were made in Hong Kong were conclusions to which they were entitled to come. They did so on the evidence before them.

15. The most recent authoritative statement of principle by which I should approach findings of fact by the Board is the judgment of Bokhary PJ in *Kwong Mile Services Ltd v Commissioner of Inland Revenue*, FACV 20/2003, at para. 37:

"In an appeal on law only the appellate court must bear in mind what scope the circumstances provide for reasonable minds to differ as to the conclusion to be drawn from the primary facts found. If the fact-finding tribunal's conclusion is a reasonable one, the appellate court cannot disturb that conclusion even if its own

> preference is for a contrary conclusion. But if the appellate court regards the contrary conclusion as the true and only reasonable one, the appellate court is duty-bound to substitute the contrary conclusion for the one reached by the fact-finding tribunal. The correct approach for the appellate court is composed essentially of the foregoing three propositions. These propositions complement each other, although the understandable tendency is for those attacking the fact-finding tribunal's conclusion to stress the third one while those defending that conclusion stress the first two."

I regard the findings to be unassailable. Indeed, on the evidence, I would have come to the same conclusion.

16. The first question raised on appeal is: "Whether the Board erred in law by failing to address the correctness or otherwise of the Assessments by reference to the three conditions as set out in *CIR v Hang Seng Bank Ltd* [1991] 1 A.C. 306 at 318E-F that must be satisfied before a charge to Profit Tax may arise under section 14 of the Ordinance".

17. The three conditions are:

(1) the taxpayer must carry on the trade, profession or business in Hong Kong;

(2) the profits to be charged must be "from such trade, profession or business," carried on by the taxpayer in Hong Kong; and

(3) the profits must be "profits arising in or derived from" Hong Kong.

All three conditions were dealt with by the Board. See paras. 9-12 above.

18. On this question, the Board referred to and relied on:

(1) the *dictum* of Lord Jauncey referred in para. 6 above;

(2) the *dictum* of Lord Bridge in *CIR V Hang Seng Bank Ltd*:

> "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";

(3) the judgment of Cheung J (as he then was) in *CIR v Bartica Investment Ltd* 4 HKTC 129 at p.159.

I have no doubt that the Board had applied the correct test.

19. Mr Thomson argued that the Board had misapplied the law because many of the activities of the appellant found by the Board to have taken place in Hong Kong were not activities from which the profits were made. The activities included:

(1) the drafting of the licence agreements in Hong Kong;

(2) the instruction of solicitors in Hong Kong for the registration of trademarks in Hong Kong and abroad;

(3) the registration of the trademarks in Hong Kong;

(4) the provisions of services of the Company Section of Lam Soon Hong Kong to the appellant, including payments on the appellant's behalf;

(5) Mr Ch'ien and Mr Chung (possibly with Mr Ho) comprised the management of the appellant and that they were based in Hong Kong;

(6) that the directors in the Cook Islands were confined to administrative duties, and that apart from signing paper minutes, they did not appear to have participated in the making of any corporate decisions.

20. Mr Thomson made the point that because these activities did not earn the profits in Hong Kong, they were irrelevant. But the Board did not find that the profits were made from these activities. What they did, which they were perfectly entitled to do, was to take these activities into consideration when deciding, on the evidence before them, where the activities which generated the profits, namely, the grant of the licences, took place and by whom.

21. The other questions of law raised in the Case Stated are:

"47. Whether on the facts as found by the Board, the Board erred in law in finding that the Appellant carried on a business in Hong Kong for the purposes of section 14 of the Ordinance.

48. Whether upon the facts found by the Board, the Board erred in law in holding that:

(a) the negotiations leading to the agreements all took place in Hong Kong [See paragraph 36 above and paragraph 33 of the Decision];

(b) the signing by the Cook Island directors of some of the licensing agreements were no more than administrative steps taken to further the business decisions taken in Hong Kong by the 2 Hong Kong directors of the Appellant who headed the management team of the Lam Soon group which the Appellant formed part [See paragraph 38 above and paragraph 35 of the Decision].

(c) the instructions for taking steps in divers jurisdiction to protect the Appellant's rights were traceable to Ms Li and Ms Leung acting for the Appellant in Hong Kong [See paragraph 37 above and paragraph 34 of the Decision].

(d) the registration and renewals of the trademarks in in Hong Kong were an integral part of the activities that produced the royalties in issue [See paragraph 37 above and paragraph 34 of the Decision].

49. Whether the Board erred in law in holding that the Assessment had validly been made by the assessor under section 60 of the Ordinance without having issued for each year so assessed a profits tax return in the form of BIR 51 as specified by the Board of Inland Revenue under section 86 of the Ordinance."

22. The answer to para. 47 is "no".

23. As to the questions raise in para. 48:

(a) No, on the evidence available to the Board, the Board was entitled to so find.

(b) No, on the evidence available to the Board, it was entitled so to find.

(c) No, on the evidence available to the Board, it was entitled so to find.

(d) No, the Board was entitled so to find. But the crux of the Board's decision was that the profits were made by the grant of licences. That the licences were negotiated and agreed in Hong Kong by persons constituting the management of the appellant who were based in Hong Kong.

24. The fourth question at para. 49 involved the interpretation of section 60. Section 60(1) provided:

> "Where it appears to an assessor that for any year of assessment any person chargeable with tax has not been assessed or has been assessed at less than the proper amount, the assessor may, within the year of assessment or within 6 years after the expiration thereof, assess such person at the amount or additional amount at which according to his judgment such person ought to have been assessed, ..."

25. It seems to be Mr Thomson's argument that there had been no assessment so far as the appellant was concerned. He argued the original assessments were made on Lam Soon Marketing Services Limited. That being the case there could be no additional assessment on the appellant. But Annexure 2 to the Case Stated makes it quite clear that the original assessments were addressed to "Lam Soon Marketing Services Limited for Lam Soon Trademark Limited". The Commissioner was entitled to do that under section 20B(2). It was an assessment on the taxpayer. Section 20B provided:

> "(1) Without prejudice to section 20A, this section applies in respect of a non-resident person who is chargeable to tax in respect of -
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> (a) Sums deemed by virtue of section 15(1)(a) or (b) to be receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong; ...
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> (2) Where this section applies, the non-resident person is chargeable to tax in respect of the sums described in subsection (1) in the name of any person in Hong Kong who paid or credited those sums to that or any other non-resident person, and the tax so charged shall be recoverable by all means provided in this Ordinance from that person in Hong Kong.
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> ...
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> (3) Where a person in Hong Kong from whom tax is recoverable by virtue of this section pays or credits to a non-resident person (whether or not he is the non-resident person who is chargeable to tax) sums described in subsection (1) he shall, at the time he makes the payment to a credit, deduct from those sums so much thereof as is sufficient to produce their amount of such tax, and is hereby indemnified against any person in respect of its deduction of such sum."

Here, as Annexure B shows, the Revenue required a return to be made pursuant to section 51(1):

> "Pursuant to section 20/20B of the Inland Revenue Ordinance (Cap.112), the above-named non-resident person is chargeable to profits tax in your name in respect of the non-resident person's assessable profits arising in or derive from a trade, profession or business carried on in Hong Kong.

> By virtue of section 51(1) of the Ordinance, (Cap.112), you are hereby required to make on this form a true and correct return of the assessable profits made by the above-named non-resident person from a trade, profession or business carried on in Hong Kong during the year ended 31 March 1999."

The return was addressed to Lam Soon Marketing Services Limited for the appellant which was permissible under section 20B(2).

26. Then Mr Thomson argued that the Commissioner ought not to have accepted the return filed. He should have made an assessment under section 59(2). That, not having been done, the Commissioner could not rely on section 60.

27. The Board dealt with this matter in para. 44 of the Case Stated. With respect, I agree with their conclusion. However, this question is connected with the question raised at para. 51 and I will deal with it further below.

28. The appellant sought to raise additional questions, only two of which remain to be dealt with by me and they are stated in paras. 50 and 51:

> "50. Whether upon the evidence before the Board and in all the circumstances of the case the Board erred in law by not considering the situs of ownership of the trademarks, namely the Cook Islands, to be the source of profit.
>
> 51. Whether upon the evidence before the Board and in all the circumstances of the case the Board erred in law by holding that the royalties, having already been charged to Profit Tax under section 15(1)(b) of the Ordinance could further be charged with Profits Tax under section 14 of the Ordinance."

29. So far as para. 50 is concerned, it has now resolved itself because Mr Thomson submitted that the reference to the *situs* of ownership of the trademarks was inappropriate. What he meant was that the Board failed to place sufficient weight on the fact that the trademarks were owned by the appellant which was a company incorporated in the Cook Islands. Put that way, it seems to me quite clear that the Board had not erred at all. The Board was fully aware of that fact. Nor can it be said they failed to place sufficient weight. What weight to place on that fact is for the Board and there is no basis upon which I can possibly interfere with their decision.

30. The point raised under para. 51 is more complicated. In the Supplemental Argument of the appellant, Mr Thomson restated the question as follows:

> "Whether upon the evidence before the Board and in all the circumstances of the case the Board erred in law by holding that the royalties, having already been charged to

> Profits Tax under section 14 as sums '*deemed to be receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong*' by virtue of the deeming provisions of section 15(1)(a) and such charge not having been objected to could further, or again, be charged under section 14(1) on the Appellant as a '*person carrying on a trade, profession or business in Hong Kong in respect of his assessable profit arising in or derived from Hong Kong for that year from such trade, profession or business*'."

Mr Thomson made two points. First, that an assessment having been made under section 15(1)(b), it would amount to a double taxation if the Commissioner seeks to tax the same royalty under section 14(1). In support of that submission, he has referred me to a *dictum* of Lord Sumner in *Bradbury v English Sewing Cotton Co. Ltd* [1923] AC 744 at p.760, where he said:

> "My Lords, I accept it as a principle now well recognized, that the various taxing Acts with which we are concerned nowhere authorize the Crown to take income tax twice over in respect of the same source for the same period of time, and that this can only be done, if at all, under statutory authority. Though the Acts nowhere say so, this principle has long been assumed. Whether the contention may ever be raised, that the Crown is not bound by mere conventions of fair play current from time to time, hitherto, at any rate, the binding force of this principle has not been questioned."

31. With respect, I do not see the relevance of that *dictum.* Section 15(1)(b) was a deeming provision which made that which was not taxable under section 14(1) taxable under section 14(1). Here, the Commissioner's point is that the original assessment was made on the basis that the royalties were "not otherwise chargeable to tax under this part". The Commissioner then took the view that the royalties were chargeable to tax. It was on that basis that the additional assessment was made under section 60(1).

32. By virtue of section 21(A), a special rate of 10% on the royalty received was payable as assessable profits in respect of a sum deemed by section 15(1)(a) to be a receipt arising in or derive from Hong Kong from a trade, profession or business carried on in Hong Kong. As the specimen additional assessment in schedule C shows allowance had been given to the appellant for the 10% paid under the original assessment. In my opinion, section 60 is wide enough to cover the present case where the appellant had been assessed at less than the proper amount and, therefore, the Commissioner may "assess such person at the amount or additional amount at which according to his judgment such person ought to have been assessed".

33. Mr Thomson made the point that the original assessments not having been objected to under section 59(2), the Commissioner could not make an additional assessment under section 60. He relied on the judgment of Mills-Owens J in *Mok Tsze Fung v CIR* [1962] HKLR 258.

34. In *Mok Tsze Fung* the issue which is relevant for the purpose of this appeal, is "whether section 60 of Cap.112 empowers an assessor to make a protective assessment (i) at all; (ii) otherwise then by invoking section 59(2) of the same Ordinance, rejecting the return previously made and estimating a sum under section 59(2)(b)". In that context, Mills-Owens J held at p.268:

> "Section 60 goes on to empower the assessor to *"assess"* the taxpayer in the required "*amount or additional amount*". The word "*assess*" is plain enough. Why should it be implied that the exercise of a power to assess is to be by way of revision or review of some earlier assessment? If the power to "*assess*" is only to be exercised by way of invoking section 59(2), and thus by reopening the first assessment, then there never would be an *"additional"* amount; action by the assessor under section 60 would, on that approach, always result in a re-assessed amount not an additionally assessed amount.
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> ...
>
> There are other provisions in favour of the view that it is not intended that action under section 60 must be by way of reassessment under section 59.
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> Thus section 60 applies the provisions of the Ordinance relating to *"notice of assessment, appeal and other proceedings"*. No mention is made of the powers of assessment conferred by the Ordinance, whether by reference to section 59 or otherwise."

Earlier at p.276 he said:

> "... In my opinion, section 60 stands on its own feet, being aimed at the case, amongst others, where following a first assessment under section 59 (whether on acceptance or rejection of a return) information comes to light justifying the assessor in inferring that the taxpayer has not disclosed the whole of his profits...."

35. In my opinion, there is nothing in the judgment of Mills-Owens J which supports the appellant's argument. Indeed, Mr Thomson's argument is similar to the argument which was rejected by Mills-Owens J.

36. For the above reasons, the appeal is dismissed.

37. I make an order *nisi*, that the respondent is to have the costs of the appeal, to be taxed, if not agreed.

(Robert Tang)
Judge of the Court of First Instance
High Court

Representation:

Mr Neil Thomson, instructed by Messrs Kwok & Yih, for the Appellant.

Mr Anthony Wu, PGC leading Mr Francis Kwok, SGC of Department of Justice, for the Respondent.