FACV No. 11 of 2006

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

FINAL APPEAL NO. 11 OF 2006 (CIVIL)
(ON APPEAL FROM HCIA NO. 7 OF 2004)

BETWEEN

KIM ENG SECURITIES (HONG KONG) LIMITED Appellant

and

COMMISSIONER OF INLAND REVENUE Respondent

Court : Mr Justice Bokhary PJ, Mr Justice Chan PJ, Mr Justice Ribeiro PJ, Mr Justice Mortimer NPJ and Lord Scott of Foscote NPJ
Date of Hearing : 12 March 2007
Date of Judgment : 29 March 2007

J U D G M E N T

Mr Justice Bokhary PJ:

1. Two aspects of revenue law are before the Court. The first is the oft-litigated one of whether profits are of Hong Kong source so as to be taxable here or of foreign source so as not to be taxable here. All the profits concerned are those of a Hong Kong stockbroker ("the Taxpayer") from four types of income earned on its customers' dealings on foreign stock exchanges. The first type is net commission or brokerage on those dealings. Each of the other three types flow from margin facilities granted by the Taxpayer to its customers for those dealings. More particularly, the second type is contango commission; the third type is sub-underwriting commission or commitment fee; and the fourth type is interest income.

2. Of those four types of income, the only one which calls for explanation at once is contango commission. Contango is, I think, generally understood as a percentage paid by a buyer of shares for being allowed to postpone taking delivery. But the word is also used to mean the premium payable under a continuation arrangement whereby a seller of shares agrees to re-buy a similar number of such shares at a future date at the same price plus a premium. And there are, I believe, other meanings or shades of meaning of the word. In its printed case the Taxpayer says that the contango commission here in question is "commission charged for margin accounts which had been inactive for 90 days based on the notional, not actual, trading of shares subject to that account". The best thing to do is, I think, to set out at once the contractual provision under which the Taxpayer's customers were charged contango commission. It is clause 9 of the margin agreements which reads :

> "If no demand for payment is received by [the customer] ..., [the customer] shall within ninety (90) days of the purchase of the shares pay to [the Taxpayer] all outstanding credit facilities. However, if [the customer fails] to do, [the Taxpayer] shall without notice to [the customer] and in addition and not in derogation of the other conditions herein, be entitled at [the Taxpayer's] sole discretion to sell at [the Taxpayer's] own judgement as to timing the shares through the Stock Exchange and immediately thereafter purchase the shares again in likewise manner (this process shall hereinafter be referred to as "contango") and thereupon, [the customer] shall have, subject to condition 1 hereof, a further ninety (90) days to settle all the new outstanding credit facilities. [The customer] further [agrees] that :-
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> (c) [the Taxpayer] at [its] sole discretion further contango the shares held by [the Taxpayer] after each period of ninety (90) days for any multiple of times until [the Taxpayer] hear from [the customer] to the contrary;
>
> (b) a commission of one per cent (1%) of the value of the shares at the date of the contango shall be paid by [the customer] to [the Taxpayer] in respect to each contango transaction."

3. As for the second aspect of revenue law before the Court, it is generated by an argument which the Taxpayer runs in the alternative to its primary argument that all of the income concerned is of foreign source and therefore not taxable in Hong Kong. Shortly stated, this alternative argument of the Taxpayers' is that there should be an apportionment if the income concerned or any of it is to be seen as of a mixed source, meaning a source which is partly Hong Kong and partly foreign.

4. This is the first case in which the subject of apportionment has reached this Court. But there is this well-known dictum in the *CIR v. Hang Seng Bank Ltd* [1991] 1 AC 306 at p.323 B-C :

> "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."

Apportionment is dealt with in Jefferson VanderWolk : *The Source of Income : Tax Law and Practice in Hong Kong* (2002). In addition to the *Hang Seng Bank* case, the author cites the cases of *Commissioner of Taxation v. Kirk* [1900] AC 588, *Commissioner of Taxation v. Hillsdon Watts Ltd* (1937) 57 CLR 36, *CIR v. Hong Kong & Whampoa Dock Co. Ltd (No.2)* [1960] HKLR 166 and *CIR v. Indosuez WI Carr Securities Ltd* [2002] 1 HKLRD 308. Having done so, he offers (at p.122) this neat statement of the net effect of the *Whampoa Dock* case and the *Hang Seng Bank* case :

> "… if it is determined that a given profit arose partly in Hong Kong and partly elsewhere, a determination of how much of the profit arose in Hong Kong must be made if it is possible to do so on a rational basis in light of all of the facts and circumstances of the case. If it is not possible to do so, then the profit must be viewed as arising either wholly in or wholly outside Hong Kong, depending on where the most important elements of the source of the profit were located."

5. Section 68(4) of the Inland Revenue Ordinance, Cap. 112, provides that "[t]he onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant". As to that, the Taxpayer points to the Court of Appeal' s decision in *Wing Tai Development Co. Ltd v. CIR* [1979] HKLR 642. As one sees at p.646, the Crown argued that a taxpayer did not discharge its onus under s.68(4) merely by proving that an assessment was excessive, but had to prove the extent to which it was excessive. The assessment in that case proceeded on the basis that certain shares which the taxpayer had sold on 4 or 6 April 1973 at an average price of $3.84 per share were worth $1.00 per share on 23 February 1973 which was the date of the agreement

pursuant to which the shares were allotted to the taxpayer. If they were worth more than $1.00 per share on 23 February 1973, then the assessment would be excessive.

6. The Board of Review found that those shares were worth more than $1.00 per share on 23 February 1973, but nevertheless affirmed the assessment. Remitting the case to the Board of Review, the Court of Appeal held (at p.648) that the Board of Review were duty-bound to reach a finding as to the true value of the shares on 23 February 1973 "however difficult it might be to do so and however much it would be a matter of guesswork". In so holding, the Court of Appeal relied on what Danckwerts J did in *Re Holt, dec'd, Holt v. IRC* [1953] 1 WLR 1488, namely find the value of shares by (as he said at p.1502) making "the most intelligent guess" that he could.

7. In the present appeal, the Taxpayer submits that if an apportionment is called for, then we should make a rough and ready apportionment of say 50:50 or remit the case to the Board of Review for it to make an apportionment however difficult it might be to do so and however much it would be a matter of guesswork.

Proceedings below

8. The assessments in question are assessments of the Taxpayer to additional profits tax for the years of assessment 1995/96 and 1996/97. Those assessments were made and confirmed on the view taken by the Revenue that all of the income concerned is of Hong Kong source rather than of foreign source as the Taxpayer contended. The Taxpayer launched an appeal to the Board of Review against those assessments on the ground that all of the income concerned is of foreign source. At the hearing before the Board of Review, counsel for the Taxpayer applied for leave to add an alternative ground to the effect that all of the income concerned is of mixed source and that there should be an apportionment. The application was opposed by counsel for the Revenue. In the case which it stated, the Board of Review said this : "Both counsel were content that the Board deferred the decision on the application until our 'main' decision on the appeal". When it came to give its decision on the appeal, the Board of Review refused the Taxpayer leave to add the "mixed source" alternative ground.

9. So the Board of Review did not entertain the apportionment question on the merits. As for the source question, the Board of Review decided it in favour of the Revenue and against the Taxpayer, holding that all of the income concerned is of Hong Kong source. Accordingly, the Board of Review dismissed the Taxpayer's appeal.

10. The Taxpayer's appeal from the Board of Review proceeded, by way of a "leap-frog" order made by Cheung JA, directly to the Court of Appeal. Initially the case which the Board of Review stated for the opinion of the Court of Appeal posed only one question. It was the source question, which is formulated thus in the Case Stated :

> "Whether, having regard to all the facts as found by the Board of Review, and on the true construction of section 14 of the Inland Revenue Ordinance (Cap.112), the Board of Review was correct in holding that the relevant profits of [the Taxpayer] for the years of assessment 1995/96 and 1996/97 arose in or were derived from Hong Kong."

The words "arose in or were derived from Hong Kong" come of course from the general charging provision for profits tax, namely s.14 of the Inland Revenue Ordinance, Cap.112. Like the *Hang Seng Bank* case and *Kwong Mile Services Ltd v. CIR* (2004) 7 HKCFAR 275, the present case does not call for a decision on what (if any) difference there is between the phrases "arising in" and "derived from" as used in s.14. In the *Hang Seng Bank* case the Privy Council did not accept that any such difference could possibly provide a basis for distinguishing *Commissioner of Income-Tax, Bombay Presidency and Aden v. Chunilal B Mehta of Bombay* (1938) LR 65 Ind App 332. And just as there had been no suggestion in the *Kwong Mile* case that the result could turn on any such difference, so is there no such suggestion in the present case.

11. Pursuant to another order made by Cheung JA, the Case Stated was amended to state the Board of Review's findings of fact more fully and to include the apportionment question, which question is formulated thus in the Amended Case Stated :

> "Whether, having regard to all the facts as found by the Board of Review, and on the true construction of section 14 of the Inland Revenue Ordinance, if, which is not accepted [by the Taxpayer], any activities in Hong Kong were to be considered as a source of the profits in question in this case, the Board of Review erred in law in refusing to consider the question of apportionment."

12. The Court of Appeal (Rogers VP and Le Pichon and Cheung JJA) dismissed the Taxpayer's appeal from the Board of Review. On the source question, the Court of Appeal appear to share the Board of Review's thinking or at least accept it as reasonable. And on the apportionment question, the Court of Appeal took the view that the Board of Review was correct not to entertain the apportionment question on the merits. This was because, the Court of Appeal said, the apportionment question was raised "very late during the hearing" before the Board of Review and, moreover, the Board of Review had "little or no material on which to assess the matter". The Court of Appeal added that "it would appear that the overseas elements in the transactions had already been catered for by reason of the commission that would be received by KES and the other brokers engaged by [the Taxpayer] to perform the various trades on the stock exchanges in Singapore and elsewhere and by the share of commission that any source brokers would be entitled to". What that refers to will become clearer in due course.

Outline of rival contentions before us

13. Appealing to us from the Court of Appeal, the Taxpayer does so primarily on the source question and, alternatively, on the apportionment question. In respect of each of the four types of income concerned, the Taxpayer contends that, contrary to the view taking by the Board of Review and the Court of Appeal, the source is foreign or, alternatively, mixed so as to call for an apportionment.

14. The Revenue contends that, as the Board of Review and Court of Appeal thought, the source of each of those four types of income is Hong Kong. As to apportionment, the Revenue contends that the Taxpayer offered no rational basis as to how such an exercise should be performed, thus leaving the Board of Review with no opportunity to investigate whether, and if so how, any apportionment ought to be made in the present case.

Kim Eng group : stock exchanges here and abroad

15. I turn now to the salient facts at all material times. The Taxpayer was a company incorporated under the laws of Hong Kong; was a member of the Hong Kong Stock Exchange; carried on the business of a stockbroker here; and was not a member of any foreign stock exchange. It was, however, a member of an international group of companies known as the Kim Eng group. At one time the Taxpayer had been a wholly-owned subsidiary of Kim Eng Securities (Private) Ltd ("KES"), a company incorporated under the laws of Singapore and a member of the Singapore Stock Exchange. By 31 March 1995, however, both the Taxpayer and KES had become wholly-owned subsidiaries of the holding company of the Kim Eng group, namely Kim Eng Holdings Ltd ("KEHL"), a company listed on the Singapore Stock Exchange.

16. And by that date KEHL also had : a 30% holding in a company of which KE-ZAN Securities Sdn Bhd ("KE-ZAN") was a wholly-owned subsidiary; a 40% holding in PT KES Sinar Mas Securities ("PT KES"); and a 52% holding in Kim Eng Securities (Philippines) Inc. ("KEP").

17. As I have already mentioned, KES was a member of the Singapore Stock Exchange. As for KE-ZAN, PT KES and KEP, they were members of the stock exchanges in Malaysia, Indonesia and the Philippines respectively. So the Taxpayer was a member of the stock exchange here and, as a company in the Kim Eng group, was associated with members of the stock exchanges in Singapore, Malaysia, Indonesia and the Philippines.

Facts found by the Board of Review

18. After dealing with the facts which I have summarised so far, the Board of Review identified certain Kim Eng group companies and personnel. The Board of Review then found facts which, however tedious that may be, I cannot avoid setting out almost in full. In so doing, I will refer to the Taxpayer and to KEP wherever the Board of Review referred to the appellant and to Kim Eng Securities (Philippines) Inc. I will use square brackets to indicate the other alterations which I have made to the wording employed by the Board of Review. And I will indicate deletions by way

of ellipsis. Such alterations and deletions do not affect the substance of what the Board of Review said. On the basis of what I have just indicated, I set out the following findings of fact from the Amended Case Stated (using little Roman numerals rather than the original numbering) :-

"(i) The Taxpayer did not dispute that net commission and brokerage earned by the Taxpayer for dealings on the Hong Kong Stock Exchange, irrespective of whether the orders came from account executives employed by the Taxpayer or by an overseas company, was taxable. It contended that net commission and brokerage from dealings in respect of stocks traded on stock exchanges in Singapore, Malaysia, the Philippines, Shanghai and Indonesia … was not taxable, irrespective of where the orders came from, including orders from the Taxpayer' s account executives.

(ii) There was no allegation that the Kim Eng group had any interests in the employer company or companies of the Japanese account executives. There was no evidence about the orders sourced by Japanese account executives.

(iii) Excluding the customer, the number of parties involved in a trade on a stock exchange ranged from one, i.e. the Taxpayer (in cases of orders sourced by the Taxpayer' s account executives to trade on the Hong Kong Stock Exchange), to three, i.e. the Taxpayer, the overseas source company and the overseas stock exchange member company (in cases of orders sourced by account executives of an overseas company to trade on another overseas stock exchange, e.g. a New York order to trade on the Singapore Stock Exchange). In a one-company scenario, the Taxpayer did not dispute that net commission and brokerage was taxable. In a two-company scenario, the Taxpayer took part in two transactions, one with the customer and the other with the overseas broker. In a three-company scenario, the Taxpayer took part in three transactions, one with the customer, one with the executing broker and one with the overseas source company.

(iv) There was no allegation and no evidence that any of the companies involved in a trade on an overseas stock exchange did not earn any income.

(v) The Kim Eng group provided brokerage services to its customers for trading in shares on local and overseas stock exchanges through fellow members in the group and through independent brokers. Where a customer was sourced by an account executive employed by, say, KES, that customer would, in the absence of any reason for taking a different course, open an account with KES and trade through his account with KES, whether on the Singapore Stock Exchange or on stock exchanges outside

Singapore. Where a customer wished to trade in, say, the Philippines, he would, in the absence of any reason for taking a different course, open an account with KEP. The Taxpayer's case was that apart from the following 3 reasons, there was no other reason why accounts were opened with the Taxpayer, instead of the local broker or the source company, for customers to trade on stock exchanges outside Hong Kong :-

(a) to circumvent the minimum commission rates prescribed by the Singapore Stock Exchange, so as to allow a lower commission rate to be charged to the customer and increase the competitiveness of the group;

(b) to allow the provision of margin facilities to customers for 'non-marginable' securities; and

(c) to allow for aggregation of orders of a customer dealing for a number of sub-accounts.

(vi) In the stock exchanges in Singapore, Malaysia and the Philippines, minimum commission rates for individual customers were then in force. In Singapore, stock brokers were allowed to give rebates to foreign stock brokers, but not individual customers. …

(vii) Thus, where a customer sourced by KES traded on the Singapore Stock Exchange through KES, the customer must pay the minimum commission and no rebate was allowed. However, where a foreign (in relation to Singapore) broker (e.g. the Taxpayer) came into the picture, KES was allowed to grant the foreign broker (e.g. the Taxpayer) a rebate. In this scenario, the foreign broker (e.g. the Taxpayer) took part in two (or more) transactions, a transaction with the customer and a transaction with KES [and a transaction with the source company where the trade was sourced by an account executive of a company other than KES and the foreign broker (e.g. the Taxpayer)].

(viii) In about 1990, the Kim Eng group began a system to circumvent the minimum commission rates prescribed by the Singapore Stock Exchange. To participate in this circumvention scheme, a customer who did not have an account with the Taxpayer must open an account with the Taxpayer, even in cases where he had already had one or more account or accounts with any other group company. It was crucial that the account through which the customer traded was with the Taxpayer.

(ix) Sharing or rebate of commission was permitted … in relation to transactions with foreign brokers in respect of stocks quoted on the Singapore Stock Exchange. The relevant transactions were transactions between KES and the Taxpayer. In a transaction between KES and the Taxpayer, both KES and the Taxpayer contracted with each other as principal. KES had to perform its side of the bargain to earn its commission (the minimum commission less up to the maximum permissible rebate to foreign brokers). If KES did not perform its side of the bargain in its transaction with the Taxpayer, the Taxpayer would not have earned its net commission and brokerage in the Taxpayer's transaction with the customer. Likewise, if the Taxpayer did not contract with KES as foreign (in relation to Singapore) broker and if the Taxpayer did not perform its side of the bargain, KES would not have been competitive and would not have earned KES' commission.

(x) As the permitted rebate under the relevant Singapore Stock Exchange bye-law was one-half of the (minimum) commission, KES would get the lion share (i.e. one-half) of the (minimum) commission, leaving the rebate of one-half of the (minimum) commission to be shared between the Taxpayer and the customer (and an overseas source company in a three-company scenario).

(xi) The circumvention of the minimum commission reason could only explain trades on the Singapore Stock Exchange sourced by account executives of KES, i.e. around 20% of the net commission and brokerage in issue [$6,492,447 out of $36,680,198 (i.e. $9,271,005 + $27,409,193) … for the year of assessment 1995/96 and $7,144,451 out of $34,141,903 (i.e. $3,694,291 + $30,447,612) for the year of assessment 1996/97].

(xii) The circumvention of the minimum commission reason did not explain the Taxpayer's involvement in trades on the Singapore Stock Exchange where orders were sourced by account executives outside Singapore (e.g. New York). There was no allegation and no evidence that any of the companies involved in a three-company scenario (i.e. an overseas source company, a different overseas stock broker, and the Taxpayer) did not earn any income. Each of the three companies, i.e. the source company, the executing broker and the Taxpayer must perform their respective sides of the bargain to earn their respective income.

(xiii) The account executive, wherever situated, would arrange for the customer to sign the account opening forms of the Taxpayer by using blank forms kept at group offices. This activity was performed by the employer of the

account executive on behalf of the Taxpayer and also on its own behalf as to enable the employer to earn its income in the event of the customer placing an order for a trade on a stock exchange outside Hong Kong.

(xiv) The completed forms would be sent to the Taxpayer in Hong Kong. The Taxpayer would open an account with the customer and input the account information into the computer in Hong Kong. Where the account opening forms were incomplete or simply not returned (e.g. in the case of institutional customers) and where the customer relationship was accepted, the Taxpayer would input account information based on information obtained from other sources. The Taxpayer's computer data included information on whether or not the customer was a margin customer, the customer's settlement instructions, including custodianship of the securities purchased; the commission to be charged by the overseas brokers and the agreed commission to be charged by the Taxpayer. These acts were performed in Hong Kong by the Taxpayer's employees on behalf of the Taxpayer. The commission to be charged by the overseas brokers was decided by KES, based on the rates prescribed by the overseas stock exchange rules. This was part of agreement making process in respect of the sharing of fees among the source company, the executing broker and the Taxpayer.

(xv) The account executive who sourced the customer would service the customer, by updating the customer with information and research materials produced by various group companies, by making recommendations, by taking orders, by relaying the orders to the appropriate stock exchange and by liaising with the customer, the Taxpayer and the executing broker. The account executive did so on behalf of his employer who did so on its own behalf to earn its income in the event of the customer placing an order for a trade on a stock exchange outside Hong Kong.

(xvi) In Singapore, Malaysia and the Philippines, the executing broker would be KES, KE-ZAN, and KEP respectively. As some Malaysian stocks were also quoted on the Singapore Stock Exchange, some dealings on Malaysian stocks took place on the Singapore Stock Exchange. Trades in Malaysia were routed through and controlled by KES. There was no direct contact between the Taxpayer and KE-ZAN. In Shanghai, the broker would be an independent broker in Shanghai or in Hong Kong. Execution and settlement of a trade was performed by the executing broker on its own behalf in performance of its transaction with the Taxpayer as a foreign (in relation to the executing broker's territory) broker. The executing broker, whether a related or unrelated party, did so on its own behalf to earn its income.

(xvii) After execution of an order on an overseas stock exchange, the account executive (or the dealer in cases where the account executive was a KES account executive) would fax to the Taxpayer's settlement department a booking sheet/trade confirmation summarising details of the executed order. If the account executive was employed by the Taxpayer, he would send a dealing ticket to the settlement department and the executing broker would send trade confirmation to the Taxpayer's settlement department. All London orders in all Asian markets were also faxed to KES. The account executive or the dealer did so on behalf of his employer who did so on its own behalf to earn its income.

(xviii) Where the account executive was not a KES account executive, the Taxpayer would send a trade confirmation to the customer. Where the account executive was a KES account executive, KES would send a trade confirmation to the customer in the name of the Taxpayer, copied to the Taxpayer. KES did so as part of the bargain between KES and the Taxpayer in the transaction between KES and the Taxpayer.

(xix) On receipt of the booking sheet/trade confirmation, the Taxpayer would perform the following in Hong Kong :-

(a) check if the details matched and input the details of the trade into its computer system;

(b) use the computer to generate a client/broker matching list, check the records on the custodian details and manually write the settlement instructions on the matching list;

(c) fax the list with the manuscript instructions to the executing broker for them to deal with the actual settlement by delivery or retention of the scripts as appropriate;

(d) fax a confirmation to the account executive where he was not at the same place as the executing broker;

(e) generate bought/sold notes and send them to the customer directly by post;

(f) generate an unsettlement report (which would not include any trade by margin customers as such trade was settled using the margin account) of all the outstanding transactions of the day to be settled and fax it to the executing broker to handle settlement;

(g) receive from the executing broker the unsettlement report with notes on settlement dates and update the settlement data in the computer accordingly;

(h) generate daily settlement reports for its accounts departments to make the necessary book entries;

(i) download from the internet daily statements of the Taxpayer's bank accounts in Singapore and Malaysia and to reconcile on a daily basis these bank statements with the settlement reports; and

(j) generate monthly commission reports.

(xx) The Taxpayer maintained bank accounts in Singapore and Malaysia, with certain officers of KES resident and stationed in Singapore being signatories.

(xxi) Settlement in Singapore was done between a broker and a central clearing house.

(xxii) For settlement of a purchase by a delivery against payment customer, the customer might pay KES or the Taxpayer the full purchase consideration due to the Taxpayer which included commission and other transaction costs. Where the customer paid KES, KES would pay to the seller through the clearing house the sum due to the seller, keep what the Taxpayer had to pay KES, and pay the Taxpayer's share into the Taxpayer's bank account in Singapore. Where the customer paid (e.g. by cheque) to the Taxpayer, KES would pay the cheque into the Taxpayer's bank account in Singapore and withdraw the purchase price and what the Taxpayer had to pay KES. For settlement of sale by a delivery against payment customer, when KES received payment from the buyer through the clearing house, KES would pay the Taxpayer's share into the Taxpayer's bank account in Singapore. KES would not pay the Taxpayer transaction by transaction but a net figure at the end of a day's trades. KES operated the Taxpayer's bank accounts in order to operate and maintain a running account between KES and the Taxpayer and to pay itself and the Taxpayer their respective entitlement in the transaction between KES and the Taxpayer.

(xxiii) Payment for custodian customers differed from delivery against payment customers in that the customers would pay to or be paid from the Taxpayer's bank accounts in Singapore.

(xxiv) Payment for margin customers are dealt with below.

(xxv) The procedure for trading on the stock exchange in Malaysia was the same as the procedure for trading on the stock exchange in Singapore.

(xxvi) Settlement of trading on the stock exchange in the Philippines was not handled by KES, but by KEP. When a customer wished to settle a purchase in a currency, say, US dollars, other than peso, the customer would remit US dollars to the Taxpayer's US dollar account in Hong Kong on settlement date. The Taxpayer would buy peso and sell US dollars through a bank and instruct the bank to remit the peso to KEP for settlement. When a customer wished to receive the proceeds of sale in a currency, say, HK dollars, other than peso, the Taxpayer would ask KEP to sell peso and buy HK dollars. On settlement date, KEP would receive payment in peso from the seller. KEP would pay the peso into its bank and instruct its bank to remit HK dollars to the Taxpayer in Hong Kong. The Taxpayer would pay the customer in HK dollars. KEP did so in settlement of its transaction with the Taxpayer.

(xxvii) In the 1995/96 and 1996/96 years of assessment, the Taxpayer earned $7,543,562 and $18,153,238 respectively as interest from margin customers trading on overseas stock exchanges. Margin trading took place in Singapore, Malaysia and Indonesia. In respect of Indonesia, the Taxpayer earned a total of US$41,912.86 in 1996/97 from margin facilities granted to Dartmoor and Top Point to trade in Indonesia. In his final submission, [the Taxpayer's counsel said that the Taxpayer] accepted that there was no evidence as to the source of funds and that the appeal in relation to that sum should be dismissed.

(xxviii) The second reason given by the Taxpayer to explain why accounts were opened with the Taxpayer for customers to trade on stock exchanges outside Hong Kong was to allow the provision of margin facilities to customers for 'non-marginable' securities.

(xxix) The Singapore Stock Exchange restricted the provision of margin facilities to securities on its prescribed list. While KES could not provide margin facilities for 'non-marginable' securities, the Taxpayer could. To provide facilities for 'non-marginable' securities, it was crucial that the facilities be provided by the Taxpayer. The provision of margin facilities by the Taxpayer enabled the customers to trade on 'non-marginable' securities

using margin facilities and enabled KES to earn its income from such trades on the Singapore Stock Exchange.

(xxx) The account executive would report a customer's request for margin facilities to [KEHL's managing director Mr Anthony Ooi] directly or through [Ms Gee Gek Leng, a director of KEHL] [Mr Ooi] would decide whether to grant or renew/extend any facility, and if so, the terms thereof, and inform [Ms Gee]. [Ms Gee] would prepare the facilities letter for the signature of [Mr Ooi] and ask the account executive to attend to signing by the customer and the provision of guarantee where required. After attending to the signing by the customer, the account executive would return the documents to [Ms Gee]. These acts were performed on behalf of the Taxpayer and also on behalf of the intended executing broker to enable it to earn its income from trades on 'non-marginable' securities. [Ms Gee] would copy the documents to [Ms Agatha Lo, an associate director of the Taxpayer] who would arrange for the opening of the margin accounts.

(xxxi) [Ms Lo] would prepare and send daily reports on the margin accounts, with details on amounts outstanding, value of security, deficit/excess security value, to [Ms Gee] who was responsible for reviewing the accounts to decide whether calls should be made and if so she would instruct the account executive to notify the customer of calls. These acts were performed on behalf of the Taxpayer.

(xxxii) The Taxpayer sourced its funds from KEHL in Singapore, KE-ZAN in Malaysia, or the Taxpayer's bank accounts in Singapore or Malaysia. In the year of assessment 199/96, the Taxpayer paid $895,700 as interest for loans from KE-ZAN to finance margin clients in Malaysia. KEHL did not charge the Taxpayer any interest.

(xxxiii) Funds sourced by KES from KEHL and funds sourced by KE-ZAN from accounts of KE-ZAN in Malaysia would be used to settle purchases made by customers and transaction charges. Funds paid in by margin customers, whether as repayments by customers or from sale proceeds, would be paid into the account of KES or the Taxpayer's bank accounts in Singapore or Malaysia and payments out were then made to repay KEHL or KE-ZAN, where appropriate, and to pay for transaction charges.

(xxxiv) KES or KE-ZAN, as the case may be, performed the acts in relation to margin trading on its own behalf to settle the trades on the stock exchange in Singapore or Malaysia and to settle the transaction between it and the Taxpayer and also on behalf of the Taxpayer in the operation of the margin

facility. KE-ZAN acted for itself in sourcing and providing funds to the Taxpayer in order to earn interest from the Taxpayer.

(xxxv) In his first Statement, [Kim Eng Securities (London) Ltd's managing director, Mr David Pirkis,] stated that most customers would be dealing for several accounts when the customers placed an order. He gave Scottish Equitable as an example and stated that UK compliance rules required the same unit price for shares and the same rate of commission for each account; that if the trade was routed to KES, KES would have to issue separate contracts and apply the commission rate applicable having regard to the volume for each account; and that if the trade was booked through the Taxpayer, the Taxpayer would be free to charge such rate as the Taxpayer thought fit, thus complying with the UK rule. He gave the UK equal treatment rule as the major reason why trades in Singapore and Malaysia were booked out of Hong Kong.

(xxxvi) However, in his Supplemental Statement, [Mr Pirkis] stated that the equal treatment rule was not the reason for Scottish Equitable to book trades through Hong Kong; that he suspected that the reason was that it already had an account with the Taxpayer; that opinions differed on whether the equal treatment rule applied only to the price or covered both the price and the commission rate; and that there were other reasons why some customers wanted to book trades through Hong Kong, e.g. the customer might already have an account with the Taxpayer. He cited a transaction as an example of using Hong Kong to 'get round the minimum commission requirement'. In answer to the Board's question why trade had to be routed through Hong Kong, he said that 'it had to be routed somewhere other than Singapore because if you did it in Singapore, you would have to show differential commission rates and the minimum commission rates'. In answer to the question by [counsel for the Revenue], 'you had to book it through somewhere outside of Singapore and usually it would be [the Taxpayer] as far as Kim Eng London was concerned', he said that 'obviously a lot or most of the clients had accounts with Hong Kong because they would also deal in Hong Kong shares'.

(xxxvii) The amount of contango commission in issue was $4,970,956 for the year of assessment 1996/97. The normal term of a margin loan was 3 months or 90 days. The margin agreement contained a provision entitling the Taxpayer to charge the margin customer commission on a notional sale and on a notional repurchase of shares if the margin loan was not repaid by the end of the term. …

(xxxviii) The contango commission and the contango commission rate was a matter to be agreed by the customer and the account executive (with the approval of [Mr Ooi] at the outset. In cases where these had been agreed, the Taxpayer would automatically charge contango commission when it was due, but contango commission could be waived or reduced by [Mr Ooi] at the request of the customer. In cases where there was no express agreement at the outset, the Taxpayer would not charge contango commission notwithstanding its entitlement under clause 9 of the margin agreement, although the Taxpayer might impose payment of contango commission as a condition for extension of the margin facility. These acts were performed on behalf of the Taxpayer.

(xxxix) In the year of assessment 1995/96, the Taxpayer received S $230,000 … which it classified as sub-underwriting commission or commitment fee. The Taxpayer granted margin facilities to 4 customers, namely Ho Wah Genting Berhad, Happy Theme Sdn Bhd, Narayansamy Sivalingam and Tan Ew Chew to trade in shares of Horiguchi Engineering Co. Ltd, a 'non-marginable' share. The Taxpayer charged these 4 customers S $250,998 as brokerage and also as commitment fee. The amount was subsequently discounted to S $230,000, and paid by cheque in Singapore dollars and deposited into the Taxpayer's account in Singapore."

Aspects of the facts stressed by the Taxpayer

19. In regard to the first of the four types of income concerned, namely net commission or brokerage on its customers' dealings on foreign stock exchanges, the facts on which the Taxpayer lays particular stress are these. All the buy or sell orders on which the Taxpayer earned such commission or brokerage were executed by foreign stockbrokers on foreign stock exchanges. The Kim Eng account executives through whose efforts the customers concerned opened accounts with the Taxpayer might be stationed anywhere. These account executives relayed orders from the customers to the executing brokers. And the Taxpayer might not even know of an order until after it had been successfully executed.

20. It will be remembered that the other three types of income concerned are contango commission, sub-underwriting commission or commitment fee and interest income. Each of these, as earlier observed, flow from margin facilities granted by the Taxpayer to its customers for their dealings on foreign stock exchanges. In regard to each of them, the facts on which the Taxpayer lays particular stress are these. Whether, and if so on what terms, those customers were granted such facilities by the Taxpayer was decided by the group holding company KEHL in Singapore. It was in Singapore that the arrangements with the customers were executed. The funds used to provide such facilities were sourced outside Hong Kong in that, as the Board of Review found, the Taxpayer sourced them from KEHL in Singapore, KE-ZAN in Malaysia or its own bank accounts

in Singapore or Malaysia. And of course the dealings for which such facilities were provided and used were dealings on stock exchanges outside Hong Kong.

Taxpayer's arguments on source

21. From the decisions of the Privy Council in the *Hang Seng Bank* case and *CIR v. HK-TVB International Ltd* [1992] 2 AC 397 there has emerged a broad guiding principle for ascertaining the source of a profit. This is that one looks to see *what* the taxpayer has done to earn the profit and *where* he has done it. The Privy Council was careful not to put that forward as more than a broad guiding principle. As was said in the *Kwong Mile* case at p.283 F-G :

> "The situations in which the source of a profit has to be ascertained are too many and varied for a universal judge-made test. Apart from the words of the statute themselves, the only constant is the need to grasp the reality of each case, focusing on effective causes without being distracted by antecedent or incidental matters."

22. On the question of what it did to earn net commission or brokerage and where it did that, the Taxpayer's argument is that, acting through foreign stockbrokers as its agents, it earned that type of income by successfully executing its customers' buy and sell orders on foreign stock exchanges. Such execution outside Hong Kong was, the Taxpayer argues, the effective cause of that type of income being earned. Everything else, it argues, was antecedent or incidental.

23. For its argument that *it* had executed the orders concerned albeit through agents, the Taxpayer relies on the maxim *Qui facit per alium facit per se* (He who acts through another is deemed to act in person). And it cites Cockburn CJ's statement in *British Waggon Co. v. Lea & Co.* (1880) 5 QBD 149 at pp 153-154 that the following instances are among the ones in which that maxim applies :

> "Much work is contracted for, which it is known can only be executed by means of subcontracts; much is contracted for as to which it is indifferent to the party for whom it is to be done, whether it is done by the immediate party to the contract, or by someone on his behalf."

The Taxpayer says that as a matter of probability if not certainty, its customers would be aware of, or at least indifferent to, the fact that it could only execute their orders on foreign stock exchanges through foreign stockbrokers.

24. In *CIR v. Wardley Investment Services (Hong Kong) Ltd* (1992) 3 HKTC 703 the Court of Appeal disregarded the acts of the foreign brokers involved in the transactions there in question. The Taxpayer submits that if the *Wardley* case amounts to a decision that the acts of agents are to be ignored on the question of source, then we should overrule it on that point. For it would then amount to a failure to apply the basic principle of agency that he who acts through

another is deemed to act in person. That principle was applied to the relevant transactions in the *Hang Seng Bank* case, *CIR v. Orion Caribbean Ltd* [1997] HKLRD 924 and the *Kwong Mile* case. One sees that in the *Hang Seng Bank* case at pp 317H and 318D, the *Orion Caribbean* case at p. 931H and the *Kwong Mile* case at pp 284 G-H and 291E-F. The instructions for purchase and sale in the *Hang Seng Bank* case were given through correspondent banks, and no overseas branch of the taxpayer was involved. It was through its parent company acting for it that the taxpayer in the *Orion Caribbean* case carried on the borrowing and on-selling there in question. And the marketing through an agent in the *Kwong Mile* case was treated as the taxpayer's exertions.

25. The Board of Review relied on the statement in the *Wardley* case at p.729 that what the foreign brokers had done did not tell one what the taxpayer had done to earn its profit or where it had done that. Only one member of the Court of Appeal referred to the Taxpayer's criticism of the *Wardley* case. This was Cheung JA who said that he felt able to decide the present case without coming to a conclusion as to the correctness or otherwise of that statement in the *Wardley* case.

26. Turning to the three types of income flowing from margin facilities granted by it to its customers, the Taxpayer cites what was said in the *Hang Seng Bank* case and the *Orion Caribbean* case about lending money. It was said in the *Hang Seng Bank* case at p.323 A-B that "if the profit was earned by … lending money … the profit will have arisen in or derived from the place where … the money was lent". In the *Orion Caribbean* case the Privy Council indicated at p.931 A-F that it did not understand that to mean that even where money had to be borrowed before it could be lent, regard should be had solely to the place of lending, to the exclusion of the place of borrowing. In the present case, the Taxpayer relies on the fact that all the places of borrowing and all the places of what it equates with on-lending were outside Hong Kong. And the Taxpayer says that there is nothing in the circumstances of the case on which properly to find a Hong Kong source despite the borrowing and the equivalent of on-lending both having been outside Hong Kong.

27. The Board of Review gave neither contango commission nor sub-underwriting commission or commitment fee separate consideration from interest income. Accepting that global approach, the Taxpayer says that all income from margin facilities represent what it earned from granting such facilities, and are of foreign source being income earned in effect by on-lending abroad money which had been borrowed abroad.

28. Still on source, some of the Taxpayer's arguments are in reply to the Revenue's arguments. I will postpone outlining these replies until after I have outlined the arguments against which they are deployed.

Revenue's arguments on source

29. As we have seen from the Amended Case Stated, the Board of Review analysed the arrangement between the source company, the executing stockbroker and the Taxpayer as one of "sharing of fees". The Court of Appeal appears to have gone along with that analysis. Rogers VP said that "[t]he net effect of the transactions was that KES would obtain one half of the minimum commission and leave the other half, termed the rebate, to be shared between [the Taxpayer] and the customer". Le Pichon JA simply agreed with Rogers VP's judgment. Cheung JA did likewise in regard to apportionment, but dealt with source upon a fuller examination of the authorities. He, too, spoke of a rebate being "shared" between the Taxpayer and the customer.

30. The Revenue's arguments on source are erected upon the analysis of the arrangement in question being one of what it calls fee-sharing. This analysis is disputed by the Taxpayer, and I will come to that in due course. At the moment, I am outlining the Revenue's arguments on source.

31. As we have seen from the Amended Case Stated, one of the facts found by the Board of Review is that "[i]n about 1990, the Kim Eng group began a system to circumvent the minimum commission rates prescribed by the Singapore Stock Exchange." The Board of Review has, as we have seen from the Amended Case Stated, called this "the circumvention scheme". As we have also seen from the Amended Case Stated, the Board of Review found that "[t]he Singapore Stock Exchange restricted the provision of margin facilities to securities on its prescribed list" and that "[w]hile KES could not provide margin facilities for 'non-marginable' securities, the Taxpayer could".

32. The Revenue's argument on source runs essentially along the following lines. It was crucial to the successful design, implementation, and continuing viability and control of the circumvention scheme that the Taxpayer be situated in and perform activities offshore (relative to the foreign stock exchanges), and Hong Kong was the designated location of interposition. The Taxpayer was an integral part of the composite scheme and was properly compensated for the essential role which it played in Hong Kong. It effectively brought together the complementary needs of customers and foreign stockbrokers, whether this took the form of circumventing the minimum commission rate regulations or the provision of margin facilities for non-marginable securities.

33. Moreover, the Taxpayer's arguments on commission income fails properly to take into account what the Taxpayer did to earn its own share of such income, as opposed to the share earned by other foreign parties to a particular securities transaction involving a Kim Eng customer. Although the profit-generating activities of the non-Hong Kong parties might be relevant in determining the source of their own share of such income, this has no bearing on the source of the Taxpayer's share thereof.

34. The interposition of the Taxpayer enabled customers to obtain margin financing for non-marginable securities. Such interposition and the activities which it performed in Hong Kong to make the interposition effective are what enabled the Taxpayer to earn interest on margin facilities.

Without its presence and activities in Hong Kong, the Taxpayer would not have been able to earn income from margin facilities. Those activities in Hong Kong brought together and gave effect to the complementary needs of customers to obtain margin facilities on non-marginable securities and of the foreign stockbrokers to earn commission from such transactions. The interposition of the Taxpayer was effected by opening margin accounts and monitoring them in Hong Kong rather than in any country in which the dealings took place. This circumvented the non-marginable securities prohibition.

35. The place where money was borrowed or on-lent is not legally determinative of the source of the income from on-lending money. Moreover these were not simple loan transactions. Both contango commission and commitment fee have the same source as interest income, arising because of the ability of the Taxpayer to provide margin financing to its customers.

36. Adopting a practical, hard-nosed and realistic factual analysis, it is plain that each of the four types of income concerned was earned by the Taxpayer as a direct result of its presence and activities performed in Hong Kong without which it would not have earned anything. The Taxpayer earned its share of each of those four types of income from what it did in Hong Kong. It was remunerated for its interposition in the business relationship between customers and foreign stockbrokers and for the necessary activities in Hong Kong which it performed to make this interposition effective.

Taxpayer disputes interposition and fee-sharing

37. I come now to the Taxpayer's arguments the outlining of which I had postponed. As we have just seen, the Revenue contends that what happened amounts to interposition and fee-sharing. The Taxpayer disputes that, putting forward the following arguments.

38. On the facts found by the Board of Review, only one entity contracted with customers and that entity was the Taxpayer. The position can be illustrated by example. Using a dealing on the Singapore Stock Exchange as the example, the position would be simply this. Contractually, the customer would place with the Taxpayer an order to buy or sell shares on that stock exchange. And upon the successful execution of the order, by KES in this example, it was the Taxpayer who would be entitled to be paid the whole of the commission from the customer. The Taxpayer would pay KES for the part which KES played in the transaction (assuming this was a two-company scenario as described by the Board of Review). It did so according to the rate agreed between them under the transaction between the Taxpayer and KES (as described by the Board of Review).

39. As the Board of Review found, the Bye-laws of the Singapore Stock Exchange permitted KES to pay a rebate of up to 50% to the non-Singaporean stockbroker, being in this example the Taxpayer. Assume for the purpose of the example that the standard rate of a transaction on the Singapore Stock Exchange was 1% of the share transaction value and that the

Taxpayer agrees a rate of 0.75% with the customer. From this 0.75% the Taxpayer would have to pay at least 0.5% to KES (since the maximum rebate is 50% of the 1%). So 0.25% is left to be earned "net" by the Taxpayer, after earning the 0.75% commission from the customer and paying KES 0.5%.

40. Thus, where the share transaction was for say US$1,000,000, the commission payable by the customer would be US$7,500. No matter what the actual mechanics of the payment and collection of the US$7,500 were, that entire sum would be paid, contractually and legally, to the Taxpayer by the customer. And as a matter of accounting, the Taxpayer would have to be credited in its profit and loss account with that entire sum as income or receipt from its business activities.

41. The customer would pay the Taxpayer that entire sum solely for the successful execution of his order in Singapore by the Taxpayer as his contractual stockbroker, acting through KES as the Taxpayer's agent. As a matter of contract, common sense and practical reality, what the customer would pay for is the successful execution of his order, not any so-called "interposition" of the Taxpayer or the Taxpayer's presence in Hong Kong.

42. Out of the US$7,500, the Taxpayer would have to pay KES US$5,000 (as the 0.5% referred to above) for its services as the executing broker. Such payment would be made under the transaction between the Taxpayer and KES. The US$5,000 would be an item of expenditure which would have to be recorded in the Taxpayer's profit and loss account. By having the order executed through its agent, the Taxpayer would earn US$7,500 from the customer. In the process KES would earn US$5,000 for itself from the Taxpayer which would pay this sum as an item of expenditure. It is therefore not a situation of US$7,500 for the Kim Eng entities concerned (the Taxpayer, the executing broker, and the overseas source company) to share according to some bargain between them. The Board of Review's statement that KES got the lion's share of the minimum commission by taking half of it and leaving the other half to be shared by the Taxpayer, the customer (and a foreign source company in a three-company scenario) is not based on an accurate legal analysis of the position.

43. Nor is the correct question : what did the Taxpayer do to earn its share of US$2,500? As can be seen from the *Hang Seng Bank* case at p.319, what has to be considered is the gross profit earned by the Taxpayer, which in this example is US$7,500. What has to be considered, therefore, is the source of this US$7,500 (and not the net sum of US$2,500 arrived at after deducting US$5,000 expenses). It is a question of what the Taxpayer (through its agent on its behalf) provided to earn this entire US$7,500, and not just a "share" amounting to US$2,500. The entire sum of US$7,500 came from the customer for one reason only, namely the successful execution of his order on a foreign stock exchange (the one in Singapore in this example) by the Taxpayer through the foreign executing stockbroker as its agent. This is why, contrary to what the Revenue argues, agency is a crucial matter in this case.

44. Once the correct sum and the correct transactions to consider have been identified, the fallacy of the Revenue's premise is obvious. Similarly the Board of Review's approach, as disclosed by its references to the Taxpayer earning its "share" of the commission, is wrong in law. By considering part of the income as if it was earned from KES or other entities rather than the whole income earned from the customer, the Board of Review identified, and therefore considered, the wrong sum and from an incorrect perspective. That confusion probably arose because the reference to rebates being given by KES to the Taxpayer created the false impression that it was KES which, in this example, allowed the Taxpayer to earn the US$2,500 by performing its side of the bargain with KES in Hong Kong. In truth the Taxpayer earned nothing from KES. Out of the entire commission which it earned from the customer, the Taxpayer paid KES 0.5%. An alternative accurate analysis is that KES charged the Taxpayer the minimum commission. Either way, the bargain between the Taxpayer and KES is not the relevant income-producing transaction.

45. To find the effective cause of the production of the income in question (the US$7,500 in this example), one looks, as a matter of law, to why the customer paid that sum to the Taxpayer, from the customer's point of view and not from the point of view of KES or other Kim Eng associates. The reference to the various sides of the bargain amongst them displays an erroneous approach in the search for the true source of the commission income. On the other hand, since KES earned its US$5,000 from the Taxpayer, it is correct to say that KES had to perform its side of the bargain with the Taxpayer to earn KES's own US$5,000. But that does not mean that KES could not, at the same time, have earned for the Taxpayer the gross sum of US$7,500.

46. No bargain between the Taxpayer, the executing stockbroker and the source company is relevant for the purpose of considering the source of the commission income earned by the Taxpayer. For the Taxpayer the income-producing bargains are the individual transactions with customers for it to enter into contracts which are successfully implemented. And the Revenue is wrong in saying that the income was earned by the Taxpayer being interposed in Hong Kong. That is wrong for these reasons :-

(i) The Taxpayer earned nothing from that bargain or any interposition.

(ii) No customer paid anything for that bargain or any interposition.

(iii) The bargain and so-called interposition merely provided the background or, at most, the opportunity for the Taxpayer to earn commission income from the customer.

(iv) So the Revenue, while appearing to disown a "but for" test, is in effect putting forward such a test.

47. For its contention that the source of profits was Hong Kong, the Revenue is driven to relying on the Taxpayer's presence and activities in Hong Kong. But such presence and those

activities go only to the existence and operation of a Hong Kong business. They do not go to the question of where the income arose or from where it was derived, which is the source question and the only question in this case.

Revenue's response

48. The Revenue's response to the Taxpayer's arguments against this being a case of interposition and fee-sharing is to say that this is indeed such a case. So saying, the Revenue argues that in substance the Taxpayer earned its actual share of commission income for its work done in Hong Kong while the foreign stockbroker and source company earned their own income for the work which they performed abroad on their own behalf.

Resolution of the rival arguments

49. Having set out the rival arguments, which I have considered it right to do at some length, I turn now to resolving them so as to arrive at a decision on the proper disposal of this appeal.

50. The bulk of the evidence relates to dealings on the Singapore Stock Exchange. In relation to dealings on the other foreign stock exchanges, the evidence is sparse. The Taxpayer is not in the position to benefit from such sparsity. After all, it bears the burden of showing that the assessments are wrong. In that endeavour, it has chosen to present its arguments as if the Singaporean position represents the entirety of this case. The Revenue accepts that approach, so the Taxpayer can rely on Singapore as representative. But there is no basis on which it can succeed in relation to any other foreign stock exchange if it cannot succeed in relation to the one in Singapore.

51. Turning to the Taxpayer's contention that what it did to earn net commission or brokerage was done abroad, the first observation which I would make is that the cornerstone of this contention is the Taxpayer's argument that *it* had executed the orders on the foreign stock exchanges albeit through agents. So, the Taxpayer argues, *it* executed those orders outside Hong Kong. For this argument, the Taxpayer relies on the notion that the acts of an agent *are* those of the principal. As to this notion, I note the observation in *Bowstead and Reynolds on Agency* 18th ed. (2006) para.1-027 (at p.21) that "such a complete identification is usually regarded as inappropriate". And I agree with the statement in that paragraph (at pp 21-22) that though approaching an agent's acts as those of the principal "has value in imposing some unity on the law applicable to situations where one party represents or acts for another, it should not be taken too literally". None of this is to ignore agency. I do not understand the *Wardley* case to suggest that agency is to be ignored.

52. As was said in the *Kwong Mile* case at p.282 C, "[j]udging the matter of source as one of practical reality does not involve disregarding the accurate legal analysis of transactions". Identifying an agent's acts with those of the principal to a degree usually regarded as inappropriate

is hardly conducive to arriving at the accurate legal analysis of transactions called for when answering a question of source. And the same is to be said of being too literal in approaching an agent's acts as those of the principal.

53. The Revenue, as I understand its arguments, is not using the expressions "interposition" or "fee-sharing" as legal terms of art. Rather is the Revenue, as I understand its arguments, using those expressions as convenient ways of referring to certain aspects of the facts found by the Board of Review. Whether or not those expressions are particularly apt, they do not betray any error of legal principle in, or otherwise undermine, the conclusion reached by the Board of Review.

54. I am unable to accept the Taxpayer's argument that the Taxpayer's presence and activities in Hong Kong go only to the existence and operation of a Hong Kong business. If the Taxpayer disputed the existence and operation of a Hong Kong business – which it does not – then its presence and activities in Hong Kong would probably be conclusive against it on such an issue. Of course the Taxpayer's presence and activities in Hong Kong are far from conclusive against it on the question of source. But that does not render such presence and activities wholly irrelevant to that question.

55. Despite all the arguments so skilfully deployed by Mr Robert Kotewall SC for the Taxpayer, I am unable to accept that the Board of Review made any specifically identifiable error of law in determining that the first type of income concerned, namely net commission or brokerage, is of Hong Kong source. Of course that alone does not end the matter. Intervention in an appeal on law only is not confined to instances in which it is apparent on the face of the record that the determination appealed against resulted from a specifically identifiable error of law. The appellate court will also correct any error of law it detects buried beneath conclusions ostensibly of fact. There are various ways of articulating the test under this basis of intervention. As one sees from the *Kwong Mile* case at pp 288D – E and 291J to 292B, this Court shares Lord Radcliffe's preference, indicated in *Edwards (Inspector of Taxes) v. Bairstow* [1956] AC 14 at p.36, to put it in terms of whether "the true and only reasonable conclusion contradicts" the determination appealed against.

56. It is well established in Hong Kong as well as in a number of other jurisdictions that source is a practical hard matter of fact to be judged as one of practical reality. In regard to net commission or brokerage, the Board of Review's most significant finding is of a fact which the Taxpayer does not deny. This is, putting it in my own words, quite simply that the successful execution of the customer's order on a foreign stock exchange had in each instance *preceded* the paperwork which made him the Taxpayer's customer for that dealing. As was its practical purpose, making the customer a customer of a stockbroker outside the country of the stock exchange on which the dealing took place freed the dealing from the minimum commission rates prescribed by that stock exchange. In the circumstances of the present case, I see no justification for saying that the true and only reasonable conclusion contradicts the Board of Review's determination that what

the Taxpayer did to earn its net commission or brokerage was done in Hong Kong. That being so, there is no room to substitute a foreign or mixed source for the Hong Kong source which the Board of Review ascribed to the Taxpayer's net commission or brokerage income.

57. This leaves the three types of income flowing from margin facilities granted by the Taxpayer to its customers. I am unable to accept the Taxpayer's argument to the effect that such income is, on the source question, simply to be equated with income earned by on-lending abroad money which had been borrowed abroad. There is a difference between the granting of margin facilities and the simple on-lending of money. And on the question of source, the difference between them can, depending on the circumstances, be crucial.

58. Despite all the skilful arguments deployed by Mr Kotewall for the Taxpayer, I am unable to see on the surface any error of law made by the Board of Review in reaching its determination that all of the income flowing from the granting of margin facilities is of Hong Kong source.

59. Was any error of law buried beneath the surface of that determination? I detect none. These were margin facilities for the dealings on which the Taxpayer earned net commission or brokerage income. The accounts on which customers were extended such margin facilities were opened with and kept by the Taxpayer in Hong Kong. That was done to enable the customers to deal abroad in non-marginable securities on margin. The customers could not have done that if the Taxpayer's presence was in any country in which those dealings took place. And the only presence which the Taxpayer had was in Hong Kong, where the margin accounts were opened and kept. In the circumstances of the present case, I see no justification for saying that the true and only reasonable conclusion contradicts the Board of Review's determination that what the Taxpayer did to earn its income flowing from the granting of margin facilities was done in Hong Kong. There is therefore no room for substituting a foreign or mixed source for the Hong Kong source which the Board of Review ascribed to the Taxpayer's income flowing from the granting of margin facilities.

Conclusion

60. For the foregoing reasons, I would dismiss the appeal in its entirety and with costs, the parties having agreed at the hearing that costs should be awarded to whichever party is entirely successful.

Mr Justice Chan PJ :

61. I agree with the judgment of Mr Justice Bokhary PJ.

Mr Justice Ribeiro PJ :

62. I agree with the judgment of Mr Justice Bokhary PJ.

Mr Justice Mortimer NPJ :

63. I agree with the judgment of Mr Justice Bokhary PJ.

Lord Scott of Foscote NPJ :

64. I agree that for the reasons given by Mr Justice Bokhary PJ this appeal should be dismissed. I want, however, to add just a few words of my own.

65. The Taxpayer's case seems to me to be based substantially on principles of agency. It is said that KES, in executing share transactions on the Singapore Stock Exchange for those whose names appeared in the Taxpayer's books as clients of the Taxpayer, was acting as agent for the Taxpayer. So, the argument proceeds, it was as though the Taxpayer itself was executing the transactions on the Singapore Stock Exchange – *qui facit per alium facit per se*. Some part of the commission paid to KES for executing the transaction found its way to the Taxpayer and constituted the gross profit earned by the Taxpayer from the transaction. The source of that profit, like the source of the commission from which the profit came, was, therefore, Singapore, where the transaction in respect of which the commission was paid was executed. So the argument runs.

66. This argument cannot, in my opinion, be right. By whose instructions was KES in Singapore acting when executing the transactions on the Singapore Stock Exchange? For whom was KES acting? There are two, and only two, alternatives.

67. One is that KES was acting on instructions given by the client for whom the transaction was executed. If that is what happened, it seems obvious to me that KES was acting for the client, not for the Taxpayer. KES would look to the client, for whom it was acting, for payment of the commission. Presumably, under the rules of the Singapore Stock Exchange, KES would have to charge the client at least the minimum commission, 1 per cent of the value of the transaction as I understand it. If, under a prior arrangement with the Taxpayer and the client, KES had agreed to pay the Taxpayer a so-called "rebate" of one-half of the 1 per cent commission and the Taxpayer had agreed to pass on to the client one-half of that rebate, then no doubt KES and the Taxpayer would comply with their respective obligations under that arrangement. The result, when the notional merry-go-round had come to a halt, would be that KES would have retained 50 per cent of the commission, the Taxpayer would have received 25 per cent of the commission and the client would have paid, net, only 75 per cent of the Singapore Stock Exchange's minimum commission. The source of the Taxpayer's profit would have been the contractual arrangement between itself, KES and the client under which its (the Taxpayer's) only obligation would have been to enter the client's name and the details of the transaction in its (the Taxpayer's) books in order to foster the pretence that the client was its client and that the transaction had been executed on its instructions by KES acting as its agent.

68. The factual arrangement referred to in the previous paragraph is consistent with the evidence given to the Board of Review. Paragraph 14 of the case stated records evidence from Grant Thornton, the Taxpayer's accountants, that :

> "… in relation to the shares traded in the stock exchanges of Singapore, Malaysia and the Philippines, the customers directly called the respective brokers [i.e. in Singapore, KES] to place orders instead of making long distance calls to the appellant and … the overseas brokers telephoned the appellant to type up the relevant contract notes *after the transactions had been completed*." (emphasis added)

69. In para.40U of the case stated, the Board of Review describe the theory of the Kim Eng scheme to circumvent the Singapore Stock Exchange's minimum commission rules :

> "Sharing or rebate of commission was permitted under Clause 2.11 in relation to transactions with foreign brokers in respect of stocks quoted on the Singapore Stock Exchange. The relevant transactions were transactions between KES and the appellant. In a transaction between KES and the appellant, both KES and the appellant contracted with each other as principal, KES had to perform its side of the bargain to earn its commission (the minimum commission less up to the maximum permissible rebate to foreign brokers). If KES did not perform its side of the bargain in its transaction with the appellant, the appellant would not have earned its net commission and brokerage in the appellant's transaction with the customer …"

Let it be assumed that this scenario, the second alternative referred to in para.66 above, corresponded with reality (which it did not), that the relevant transaction to be executed on the Singapore Stock Exchange was a transaction in respect of which the instructions were given by the Taxpayer and that KES was acting for the Taxpayer. What follows? First, KES would look to the Taxpayer for payment of its commission, the minimum commission less the maximum rebate. The Taxpayer would have to pay KES 0.5 per cent of the value of the transaction. There is no profit so far for the Taxpayer. Next, the Taxpayer would charge its own client whatever commission was payable under the contractual arrangement between itself and the client i.e. the 0.5 per cent that it had had to pay KES plus an add-on, its own profit, of one-half of that 0.5 per cent (I am taking all these figures from para.39 of Mr Justice Bokhary PJ's judgment).

70. What would be the source of the Taxpayer's profit in the two alternatives I have postulated? In each the profit would have been earned under a contractual arrangement separate and distinct from the contract under which the commission on the share transaction had become payable. Under the first alternative, the commission would be payable for the Taxpayer's services in representing KES' s client as its client and the transaction, the instructions for which were given by the client to KES, as a transaction executed by KES for it, the Taxpayer. This "dressing-up" arrangement for which the Taxpayer earned its profit was orchestrated and implemented in Hong Kong. The source of its profit was, in my opinion, Hong Kong.

71. On the alternative scenario, which did not, in my opinion, accord with reality, the Taxpayer' s profit was earned from its contractual arrangement with its client. The opportunity to earn the profit would have been derived from the Singapore share transaction between KES and the Taxpayer, but I do not think that would be enough. If a Hong Kong client instructs a Hong Kong stockbroker to arrange a purchase or sale shares on the Singapore Stock Exchange on the footing that the client will reimburse the Hong Kong broker the amount of the commission payable to the Singapore broker and will, in addition, pay the Hong Kong broker a sum equal to 50 per cent of that commission, I would regard the profit made by the Hong Kong broker in executing those instructions as sourced in Hong Kong.

72. In the events that happened, however, the Taxpayer' s "clients" were in reality KES' s clients, the instructions were given to KES by the clients, not by the Taxpayer. The Taxpayer' s role was no more than a book-entry role in Hong Kong. Whatever view the Singapore Stock Exchange authorities might take of the arrangements made by KES, the Taxpayer and the clients, the Hong Kong tax authorities and the courts below were, in my opinion, quite right not to be misled by them. For these reasons, as well as those given by Mr Justice Bokhary PJ, I would dismiss this appeal.

Mr Justice Bokhary PJ :

73. The Court unanimously dismisses the appeal with costs.

(Kemal Bokhary) Permanent Judge

(Patrick Chan) Permanent Judge

(R A V Ribeiro) Permanent Judge

(Barry Mortimer) Non-Permanent Judge

(Lord Scott of Foscote) Non-Permanent Judge

Mr Robert Kotewall SC and Mr Stewart Wong (instructed by Messrs Lee & Li) for the appellant, the Taxpayer

Mr John Bleach SC and Mr Jin Pao (instructed by the Department of Justice) for the respondent, the Revenue