CACV 57/2006

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

CIVIL APPEAL NO. 57 OF 2006
(ON APPEAL FROM HCAL NO. 118 OF 2004)

BETWEEN

COMMISSIONER OF INLAND REVENUE	Applicant
and	
BOARD OF REVIEW (INLAND REVENUE ORDINANCE)	1st Respondent
INDOSUEZ W I CARR SECURITIES LIMITED	2nd Respondent

Before: Hon Rogers VP, Le Pichon JA and Sakhrani J in Court
Dates of Hearing: 20-21 March 2007
Date of Handing Down Judgment: 27 April 2007

J U D G M E N T

Hon Rogers VP:

1. This was an appeal from a decision of Deputy High Court Judge Mayo given on 4 January 2006. The matter before the judge was an application for judicial review of a ruling by the Inland Revenue Board of Review ("the Board") dated 22 July 2004. In that ruling the Board declined to state a case in respect of one of its decisions namely a decision dated 17 November 2003 which was given following a judgment of Deputy High Court Judge Longley given on 30 January 2002 with the judge's order being perfected on 24 April 2003. That judgment had been in respect of a previous case stated in the same matter.

2. Deputy High Court Judge Mayo granted an order of Certiorari to bring up the ruling made by the Board on 22 July 2004 to be quashed and granted an order of Mandamus requiring the Board to state a case under the provisions of section 69 of the Inland Revenue Ordinance Cap.112 ("the Ordinance"). The case to be stated was to be based on 13 questions posed by the applicant. At the conclusion of the hearing of this appeal judgment was reserved.

Background

3. The taxpayer is a stockbroking company which is a member of an international group. Its office in Hong Kong serves as the centre or headquarters of the group for the Asia Pacific Region. It appears that the taxpayer has virtually no retail clients: its clients were almost exclusively major financial institutions. It is unnecessary to consider the full details of the taxpayer's operations save to say that they are set out in the first decision of the Board dated 10 May 2000. Each client of the taxpayer would sign an agreement with the taxpayer under which the taxpayer would be entitled to broker commission.

4. In respect of Hong Kong clients the taxpayer would forward any orders on to the relevant overseas office and in cases where there was no overseas office to an overseas broker. The transaction would then be carried out and after the matter was reported back to Hong Kong the various bargain slips would be generated in Hong Kong and the client would be informed by the Hong Kong office of the completion of the order.

5. In respect of overseas clients whose orders for dealing were obtained by other offices, the order would be sent by fax to the taxpayer in Hong Kong and a copy of that was then faxed to the relevant office. Again, the taxpayer would prepare the bargain slip in Hong Kong and inform the overseas office who received the order in the first place of the execution of the order. The Hong Kong office would issue a confirmation to the client of the deal that was effected. As the Board found, although the execution and settlement of the orders necessarily took place outside Hong Kong all back-office functions such as the confirmation of the transaction and the accounting were carried out in Hong Kong. In addition to that there were the matters of liaison with the clients and also the preparation of research. Much of the research appears to have been carried out by overseas offices of the taxpayer's group.

6. The issues in this case arise out of assessments made for the years 1992/93, 1993/94 and 1994/95. The taxpayer objected to the assessments by the Commissioner on the basis that the assessed profits neither arose in nor were derived from Hong Kong, and as such, were outside the scope of the charge to profits tax as imposed by Part IV of the Ordinance. It was on that basis that an appeal was made to the Board which resulted in the first decision referred to above, that dated 10 May 2000

The first decision of the Board

7. In its first decision, the Board reached the conclusion that the commission earned from overseas clients arose substantially from an offshore source. As such, it allowed the appeal in respect of that aspect of the assessable profits. However in relation to the commission from Hong Kong clients the Board held that the efforts of the taxpayer in Hong Kong were the substantial reason why the taxpayer was able to generate the profits it did. It went on to say, however, that there were foreign elements which contributed to the production of those profits and in particular the orders had to be managed overseas and basic research had to be performed overseas in respect of overseas transactions.

8. It is not entirely clear what stance the taxpayer took in relation to whether or not there should be an apportionment of the profits which were earned in respect of overseas transactions carried out on the instructions of Hong Kong clients. Certainly it was not mentioned in the letters of 30 July 1999 when the taxpayer gave notice of appeal to the Board. This court was shown copies of parts of the transcript of the hearing leading to the first decision of the Board. It would appear that at a very early stage the chairman of the Board raised the question of whether there should be an apportionment and counsel for the taxpayer indicated that he did not think that that would be so as the taxpayer was relying on the fact that the research and the carrying out of the orders, which both took place outside Hong Kong, constituted the major factors in relation to the generation of the income. Later on in the transcript it appears that counsel for the taxpayer attempted to dissuade the Board from any notion that there should be apportionment. However, for reasons which will become apparent below, it appears that that might not be the full picture.

9. Whatever the arguments were before Board on that occasion, the Board referred to the question of apportionment in its first decision. It considered that common sense would require apportionment but it came to the conclusion, albeit with reluctance, that on the state of the authorities it could not make any apportionment. The Board went on, however, to analyse how it considered the commission generated from orders given by Hong Kong clients arose and it said that it considered that the predominant source, as well as the place where the acts took place which were more immediately responsible for the receipt of the profits, was Hong Kong. It took into account the fact that the research and management of the orders took place overseas but it went on to indicate the important parts played by the taxpayer in Hong Kong. Having done that, the Board

indicated that it would have apportioned the profits derived from commission earned from Hong Kong clients to be 60% onshore 40% offshore.

The case stated

10. The Board was asked to state a case in respect of its first decision. The body of the case which was thus stated followed closely the decision. In relation to the question of apportionment the Board said at paragraph 35:

> "Mr. Thomson's position before us was that if the source of profits were to be identified as both onshore and offshore, the Board would have a duty to apportion the profits."

11. As already noted, the excerpts from the transcript of the hearings leading to the decision do not entirely bear that out. Indeed, it would appear that, at least in those passages in the transcript which were provided to this court, Mr Thomson was arguing that the profits should be held to be offshore and that the Board should not embark upon the question of apportionment.

12. There was some disagreement between the parties as to what the questions should be. The Commissioner put forward questions which were ultimately questions (1) and (3). They read as follows:

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

13. The Taxpayer put forward questions (2), (4) and (5). They read as follows:

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

(4) Whether on the facts found by the Board of Review, the Board of Review erred in law in concluding that the source of profits generated by the Taxpayer from orders from Hong Kong clients executed on overseas markets was predominantly Hong Kong or that Hong Kong was where the acts more immediately responsible for the receipt of the profits were undertaken.

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

14. It thus came about that the question of apportionment became the focus of argument.

The judgment and order on the case stated

15. Deputy High Court Judge Longley answered the first and third questions posed in the case stated in the affirmative. This thus threw open the question as to the Taxpayer's success in securing the first decision in respect of overseas clients. In respect of Hong Kong clients the judge answered question (2) in the affirmative in so far as the Hong Kong clients were concerned and then went on to hold the answer to question (5) in the negative. The order made by the judge on that occasion is of some importance. The matter was remitted to the Board for the purpose of reconsidering its conclusions in respect of the answers which had been given and in particular reference can be made to the fifth paragraph of the order remitting the matter which read:

"In the light of the opinion of the Court that it was both permissible in law and appropriate for the Board of Review to apportion profits derived from commission earned from Hong Kong clients for the execution of orders in the overseas markets, and in the light of its reconsideration under (4) above, apportioning the said profits."

16. There was some delay in drawing up that order and that was occasioned because, apparently, it was argued on behalf of the Commissioner that there should be a further paragraph to the order which was ultimately inserted which read as follows:

"(6) In the light of the opinion of the Court that apportionment is permissible in law to consider whether profits generated by the Taxpayer from orders from overseas clients on overseas markets should be apportioned and, if so, in what proportion."

17. What appears to me to be significant in this case is that there was no appeal by the Commissioner from the order of the judge remitting the matter to the Board on the basis that the Board should consider apportionment. On the contrary the Commissioner applied to expand the order in relation to the question of apportionment to matters relating to overseas clients as well as to Hong Kong clients. That application was acceded to by the judge. This is, perhaps, a little surprising in view of the fact that it had been the Commissioner's case that there was, in any event, insufficient evidential basis for any apportionment to be made.

The second decision of the Board and the application for a case to be stated

18. When the matter was remitted to the Board, it came to the conclusion that the profits generated from orders derived from overseas clients arose substantially from an offshore source and that there was no need for there to be any apportionment. In respect of the profits that were generated from orders which came from Hong Kong clients, the Board concluded that there should be apportionment and it revised its assessment to 50% onshore and 50% offshore.

19. Following that decision the Commissioner requested the Board to state a new case. The questions which it requested to be included in that case stated were as follows:

(1) Whether the Board misdirected itself on the relevant test for determining the source of the profits, namely, in stating the test to be '*what the taxpayer or its agent did to earn the profits and where was this done*'

(2) Whether, even where a service was in law performed by an overseas agent (a local broker, or overseas office or subsidiary) on behalf of the taxpayer, the Board erred in law in failing to take into account what the precise commercial arrangements were between the taxpayer and such agent, including whether such service had been purchased by the taxpayer by the payment of a fee or commission representing the value of such service.

(3) Whether the Board erred in law in finding that the execution of orders by local brokers was relevant in determining the source of the taxpayer's profits, having regard to :-

(a) its finding that such brokers had been paid their own commission for providing such service and the evidence in support of such finding; and

(b) the Court's finding that the taxpayer derived its profits '*from the difference between the commission it charged to the client and the commission it had to pay the local stockbroker*'.

(4) Whether :-

(a) the Board's finding that the management of clients' orders were functions performed by the overseas offices and subsidiaries is supported by any evidence, and

(b) the Board, in making such finding, failed to take into account its early finding at paragraph 5(4) of the Decision.

(5) Whether :-

(a) the Board erred in law in inferring from the facts found that '*the overseas offices and subsidiaries which performed these functions [ie the processing, handling and management of the orders] must have been doing the work on behalf of the taxpayer*; and

(b) there is any evidence in support of such finding.

(6) Whether, even if the orders of the overseas clients were processed, handled and managed by the overseas offices, the Board erred in law in failing to take into account any payment or fee or commission made by the taxpayer to such offices and subsidiaries on behalf of the taxpayer to such offices and subsidiaries to compensate them for the said services, or to ascertain whether such payment had been made.

(7) Whether, having excluded :-

(a) the building up and maintenance of a relationship with a client; and

(b) the provision of quality research reports

as acts done by the Taxpayer's overseas offices on behalf of the Taxpayer, the Board erred in law in not altering its earlier view that the Taxpayer's activities in Hong Kong were merely '*minor and indirect*'.

(8) Whether the Board erred in law in inferring that the Taxpayer's activities in Hong Kong which contributed to the making of the profits from overseas clients were '*minor and indirect*', having regard to :-

(a) the facts found by the Board and

(b) the matters set out in the preceding questions.

Alternatively, whether the Board erred in law in holding that the Taxpayer has, on the facts found by the Board, discharged its burden to show that the said activities were '*minor and indirect*'.

(9) Whether, in apportioning the profits attributed to Hong Kong clients as 50% onshore and 50% offshore, the Board failed to take into account whatever fee or commission had been paid to the taxpayer's overseas agents or brokers.

(10) Whether the Board erred in law in making an apportionment on such basis when the taxpayer has failed to affirmatively establish that part of the profits which arose outside Hong Kong or where there is no evidence in support of such apportionment.

(11) Whether the Board erred in law in making any apportionment as regards the profits attributed to the Hong Kong clients on the facts of this case.

(12) Whether on the facts found by the Board, and on the matters set out above, the Board erred in law in not concluding that source of profits derived by the taxpayer from orders from Hong Kong clients executed on overseas markets was Hong Kong or predominately Hong Kong.

(13) Whether on the facts found by the Board, and on the matters set out above, the Board erred in law in not concluding that source of profits generated by the taxpayer from orders from overseas clients executed on overseas markets was Hong Kong or predominately Hong Kong."

20. The matter therefore came before the Board again on the Commissioner's application and, in a ruling dated 22 July 2004, the Board refused to state a further case. In the ruling the Board analysed the various questions which were put forward. In commencing its decision the Board said at paragraph 5:

> "Although this application for case stated is made in respect of the November 2003 decision, many of the questions sought to be raised do not relate to the matters decided by the Board in that decision at all. Rather, these are questions-if they are proper questions at all-which could have been raised by or on behalf of the Commissioner at the hearing in January 2000. They were not raised then. Nor were they sought to be raised at the time when the Commissioner put forward questions of law for the determination by the Court of First Instance. They were not even attempted to be raised in argument before this Board at the hearing in July 2003."

21. That reasoning, the Board held applied specifically to question (1) and the Board held that it would be an abuse of the process for the Commissioner to seek to raise the question that this

stage. The same reasoning was said to apply to the questions (2), (6) and (9). The Board went on to say that it had difficulty in understanding question (3) particularly in the light of the judgment of the court. The same applied to question (10). In respect of that question, as in respect of questions (4), (5), (7) and (8), it was said that those questions related to facts and not law. In relation to the final questions (11)-(13) it was said that those questions added nothing to what had gone before and were merely wrapup questions.

The application for judicial review

22. On the application for judicial review the main point of contention appears to have been whether all 13 questions either had already been the subject of the previous review, at least in substance, or, if that had not been the case, whether they should have been ventilated on that occasion. The judge summarized his conclusions in the following paragraphs:

> "49. In particular it is necessary for me to consider the issues which were before the Board when they decided both of the decisions.
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> 50. The most obvious difference is the fact that when the Board was seized of the 2nd hearing they did so on the basis that an apportionment was definitely required so far as Hong Kong clients were concerned and that they were required to consider whether an apportionment was appropriate in relation to the overseas clients.
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> 51. In my view, this went to the very root of the matters which the applicant is seeking to raise in the 13 questions which were placed before the Board.
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> 52. There were also the other matters earlier referred to where the Board changed its findings in the light of the directions it received from Longley DJ.
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> 53. The 2nd respondent has not discharged the burden placed upon it of demonstrating that the questions constitute an abuse of process."

This appeal

23. On this appeal, Mr Thomas SC, who appeared on behalf of the taxpayer, drew attention first of all to the provisions of the Ordinance. Section 66 gives the right of appeal to the Board. The Board's powers are contained in section 68 and section 68(8) provides:

> "(8) (a) After hearing the appeal, the Board shall confirm, reduce, increase or annul the assessment appealed against or may remit the case to the Commissioner with the opinion of the Board thereon.

(b) Where a case is so remitted by the Board, the Commissioner shall revise the assessment as the opinion of the Board may require and in accordance with such directions (if any) as the Board, at the request at any time of the Commissioner, may give concerning the revision required in order to give effect to such opinion."

24. Section 69(1) provides that the decision of the Board shall be final. It reads:

"(1) The decision of the Board shall be final:

Provided that either the appellant or the Commissioner may make an application requiring the Board to state a case on a question of law for the opinion of the Court of First Instance. Such application shall not be entertained unless it is made in writing and delivered to the clerk to the Board, together with a fee of the amount specified in Part II of Schedule 5, within 1 month of the date of the Board's decision. If the decision of the Board shall be notified to the Commissioner or to the appellant in writing, the date of the decision, for the purposes of determining the period within which either of such persons may require a case to be stated, shall be the date of the communication by which the decision is notified to him."

25. Once a case has been stated the matter is dealt with by the Court of First Instance, except in special cases. Section 69(5) then provides as to the orders that can be made:

"(5) Any judge of the Court of First Instance shall hear and determine any question of law arising on the stated case and may in accordance with the decision of the court upon such question confirm, reduce, increase or annul the assessment determined by the Board, or may remit the case to the Board with the opinion of the court thereon. Where a case is so remitted by the court, the Board shall revise the assessment as the opinion of the court may require."

26. It was said that there were three possible interpretations. Either it was possible for there to be a second case stated or, as the Board appeared to consider was the case, there could be a second case stated in relation to issues which arose on a decision of the Board following remission of the matter from the Court as a result of a judgment on a first case stated or, finally, the position could be that there could be no second case stated. It was Mr Thomas's primary submission that the Ordinance did not permit a second case stated.

27. It was said that the effect of the statutory provisions was that after a case stated has been heard and the matter remitted to the Board, the Board's only function would be to revise the

assessment in accordance with the court's ruling. There is thus no power in the Board to hold a further hearing and hence no power for there to be any further case stated.

28. Although not relied upon specifically by counsel for the taxpayer, reference can be made to the case of *Yau Wah Yau v The Commissioner of Inland Revenue*, CACV 97 of 2006 8 December 2006. This court followed an earlier decision, again of this court, and held that there was no power to remit a case for rehearing *de novo* by the Board. Le Pichon JA said at paragraph 5:

> "It is clear that the statutory provisions do not confer any general power to remit the case to the Board for rehearing *de novo.* See *Commissioner of Inland Revenue v Hang Seng Bank Ltd* 2 HKTC 614 at 638 where Cons VP observed that the jurisdiction of the court under section 69:
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> "is to "hear and determine any question of law". We may, in accordance with our decision, "confirm, reduce, increase or annul the assessment determined by the Board". We may also … remit the case to the Board with our opinion thereon, but that opinion would have to relate to a question of law. We have no power to remit for the Board to reconsider their findings on the facts. We have to take these as the Board has found them. We may only interfere if the findings are not justified by the evidence." "

It was thus clear that there is no power for the Board to hear further evidence. The power of the Board is to "revise the assessment as the opinion of the court may require."

29. During the course of the hearing I was initially very attracted to the taxpayer's argument and so indicated. However, having considered the matter further I have come to the conclusion that it is not correct. In my view, the position must be that an application requiring the Board to state a case under section 69(1) may be made when the Board makes a decision. The Board makes a decision just as much when it "revises the assessment" after the matter has been remitted to it by the court as it does in the first instance after hearing the appeal. It is one thing that when the matter is remitted to the Board under section 69(5) there is no power to require or empower the Board to hear the appeal again: see *Yau Wah Yau v The Commissioner of Inland Revenue*. It is quite another thing to suggest that the Board does not issue a decision, even if the terms of that decision are somewhat constrained by the order of the court.

30. It is notable that section 68(8) does not refer to a decision but refers to the power of the Board to "confirm, reduce, increase or annul the assessment" and also the power of the Board to remit the case to the Commissioner. The reference to "decision" comes in section 69(1). It would seem, therefore, that the reference to "decision" in section 69(1) is a reference to the document by which the Board announces how it proposes to perform its function under section 68(8). In this respect, I would also mention that the wording of the Ordinance has, it would

seem, to be read with some degree of latitude. The power given to the Board under section 69(5) after a case has been remitted by the court cannot be construed so restrictively that the Board can only revise the assessment, in a strictly literal sense, but it must include power in the Board to remit the case to the Commissioner.

31. On the basis, therefore, that each time a Board performs its function under section 68(5) it does so in the form of a decision there is no reason why that decision should not be the subject of a case stated under section 69(1). The fact that there is no power in the Board to hear further evidence when a case is remitted to it by the court in no way detracts from that conclusion.

32. The other question which fell to be decided was whether the Board was correct in refusing to state a case on the basis that it did. The judge held, as already noted, that these 13 questions which were placed before the Board went to the root of apportionment. In my view, the questions which were placed before the Board did indeed relate to the issue of apportionment. Mr Ho SC, who appeared on behalf of the Commissioner, took this court through each of the questions and demonstrated that these questions did arise in an acute form when the matter of apportionment had to be considered. Whereas I would not to demur from the view taken by the Board that it would be an abuse to seek to raise questions on a case stated that arose out of a previous decision, that, in my view, is not the position here.

33. As Mr Ho pointed out the questions are directed to the identification of the activities that gave rise to the profits. Taking question (1), Mr Ho pointed out that even on the basis that what had been done abroad was done by the taxpayer's agents that was not sufficient. The question that had to be asked was what fees were referable to what matters. As has been pointed out by the Court of Final Appeal in the decision in *Kim Eng Securities (HK) Ltd v Commissioner of Inland Revenue* FACV 11 of 2006, decision 29 March 2007, without ignoring agency an accurate legal analysis of transactions when answering a question of source may require that the court's approach cannot be too literal and may require further analysis: see in particular paragraphs 51-53 (per Bokhary, Chan, Ribeiro PJJ and Mortimer NPJ) and 71 (per Lord Scott NPJ) of the judgments. Although that judgment was handed down after the hearing of this appeal, at the inception of the hearing this court drew the attention of the parties to the fact that that appeal had been heard. At the risk of delaying this judgment, after the Court of Final Appeal's judgment had been handed down the parties were asked if they wished to make any submissions in respect of anything arising out of that judgment.

34. Further submissions were received. Those on behalf of the taxpayer sought to emphasise that the matter involved in the present case was the question of whether there should be judicial review of the Board's refusal to state a case. In so far as reference was made to the judgments it was sought to distinguish that case on its facts from the present case and to submit that the views expressed by Lord Scott, specifically in his second alternative analysis, were neither adopted nor considered by any other member of the court.

35. In contrast the submissions on behalf of the Commissioner sought to point out that although the *Kim Eng* case did not involve apportionment, the questions arising on apportionment should be considered in the light of that decision.

36. In my view, questions (2), (3), (6) and (9) are directed to what the correct conclusion must be having regard to the fact that the overseas brokers and offices received commission. This must be highly relevant as to how the any apportionment should be made. Question (3) likewise is directed to looking at the component parts of what took place to see what activities had significance. These are all matters which arise in relation to apportionment and although, of course, the findings of fact are important, the issues involved include questions of law and relate to the matter of apportionment.

37. Although the Board considered questions (4), (5), (7) and (8) related to matters of fact and not law, it would seem that, on the face of the matter, questions (4) and (5) must relate to matters of law since they question whether there is any evidence to support the particular findings. Questions (7) and (8) appear to me to raise the question as to whether the inevitable consequence of the findings dictated that the Board must have erred in law. Again, question (10) raises the question as to whether there was sufficient evidence to support the apportionment made by the Board. The remaining questions would appear to be umbrella questions seeking to encompass the issues raised.

38. I would simply add that because of the absence of any appeal from the judgment of Deputy High Court Judge Longley, the Board is bound to consider the question of apportionment. This would seem to be the first time that has happened and there is no doubt that the task itself raises difficult questions even though the ultimate result is a finding of fact. Following the conclusion of the appeals in *Kim Eng Securities (HK) Ltd v Commissioner of Inland Revenue* it may well be that this is a situation which is less likely to arise in the future. That, however, must be a matter which has to be decided on another occasion.

Conclusion

39. In the circumstances I consider that this appeal falls to be dismissed. I would therefore make an order accordingly with an order *nisi* that the costs of this appeal be to the Commissioner.

Hon Le Pichon JA:

40. I agree.

Hon Sakhrani J:

41. I also agree.

(Anthony Rogers)	(Doreen Le Pichon)	(Arjan H Sakhrani)
Vice-President	Justice of Appeal	Judge of the Court of First Instance

Mr Ambrose Ho SC & Mr Michael Yin, instructed by Department of Justice, for the Applicant/Respondent

Mr Michael Thomas SC & Mr Neil Thomson, instructed by Messrs Johnson, Stokes & Master, for the 2nd Respondent/Appellant