HCIA 3 and 4/2007

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION

COURT OF FIRST INSTANCE
INLAND REVENUE APPEAL NOS. 3 and 4 OF 2007

BETWEEN

COMMISSIONER OF INLAND REVENUE Appellant

and

DATATRONIC LIMITED Respondent

Before: Hon Chung J in Court
Dates of Hearing: 16 April 2008 and 17 April 2008
Date of Handing Down Judgment: 13 June 2008

J U D G M E N T

Introduction

1. Both the Commissioner of Inland Revenue ("*the Commissioner*") and the taxpayer disagree with the determination of the Board of Review ("*the board*") dated 6 June 2007 on points

of law. Both applied to the board to state a case. The proviso to s. 69, Inland Revenue Ordinance (Cap. 112) stipulates:-

> "…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".

As can be seen in para. 3 below, the taxpayer's case-stated is in the nature of a "cross-appeal".

2. The questions of law in the case-stated formulated by the Commissioner are:-

> (a) "[whether], on the facts as found by the Board, the Board was correct in law in concluding … that the Taxpayer's profits were manufacturing profits and a part of such profits was sourced in the PRC";
>
> (b) "[whether], on the facts as found by the Board, the Board was correct in law in concluding … that the Taxpayer had undertaken operations in the PRC and such operations were important operations and attributable to the profits in question";
>
> (c) "[whether], on the facts as found by the Board, the Board was correct in law in concluding … that an apportionment of profits should be made on a 50:50 basis"

(para. 11.5(a) to (c), case-stated).

3. The questions of law in the case-stated formulated by the taxpayer are:-

> "[whether], on the facts as found by the Board, the Board was correct in concluding … that:
>
> (i) DSC was not the agent of the Taxpayer; and
>
> (ii) The transactions between the Taxpayer and DSC were import processing rather than contract processing"

(para. 11.5(d), case-stated).

4. DSC in the above paragraph is the abbreviation for "Datatronic (Shunde) Corporation (**連達順德電子有限公司**)". It is common ground both before the board and this court DSC is a wholly-owned subsidiary of the taxpayer which was established in the Mainland in 1993.

5. The dispute between the parties concerns the additional profits tax assessed by the Commissioner for the years (1) 1999/2000 (additional profits tax of about $5.59 million); (2) 2000/2001 (additional profits tax of about $5.84 million) and (3) 2001/2002 (profits tax of about $4.46 million).

6. The board allowed the taxpayer's appeal on 6 June 2007.

Relevant Facts

7. Most of the background facts are undisputed and can be summarized as follows.

8. The taxpayer is a Hong Kong private company incorporated in 1971. Its business is described in a schedule submitted to the Commissioner:-

> "The principal activities … are manufacture and sale of ***electronic components***. The [taxpayer] operates a ***factory in Hong Kong*** in which certain products are manufactured. Owing to the high production costs in Hong Kong, the [taxpayer] engaged [***DSC***] in Shunde, China for ***manufacturing*** its electronic products. According to the ***processing agreement*** … [DSC] provided factory premises and labour whereas the [taxpayer] provided technical know-how , training, production skills, design, supervisory and management team and raw materials for production purposes … " (emphasis supplied) (para. 2.7, case-stated).

9. The facts upon which the taxpayer's contention against the tax assessment is based are:-

> "[The taxpayer] established DSC … that aims at complying with the administrative issues in the PRC … The manufacturing operation is still ***under the control*** of [the taxpayer]. …
>
> [DSC] is established as an ***extended assembly base*** of [the taxpayer] in the PRC for comparative low production costs … " (emphasis supplied) (para. 2.12(a) and (b), case-stated).
>
> "According to the Departmental Interpretation and Practice Notes No. 21 ['DIPN 21'], … paragraphs 15 and 16 [thereof] set out a typical processing operation … Although the Mainland processing unit is a separate and distinct unit from the Hong Kong manufacturing business, the [Commissioner] is prepared to ***concede*** that the profits in question can be ***apportioned*** on 50:50 basis if the [taxpayer] is involved in the manufacturing activities in the Mainland" (para. 2.15, case-stated).

10. The taxpayer re-stated essentially the same case as follows:-

> "… the true arrangement between [the taxpayer] and DSC is ***not import processing***. … While the form of documents used … [for] the import of materials by [the taxpayer] for DSC's use are those … for import processing because of PRC legal requirement, the simple truth is that all along ***DSC has not paid*** for the materials sent to it by [the taxpayer] under such form. … " (emphasis supplied) (para. 2.18(b), case-stated).

The Main Issue Before the Board

11. The Commissioner disputed that, on the facts found, the taxpayer was entitled to rely on the tax concession referred to in DIPN 21.

12. According to the contents of the case-stated, the Commissioner placed emphasis on the form adopted by the taxpayer and DSC: the dealings between them took the form of trading using CIF or FOB contracts; DSC was named as a principal party therein. DSC's business licence did not permit it to export its products except by way of sale either.

13. In gist, the Commissioner contended that the taxpayer was bound by the form and the fact that the taxpayer never paid for the goods "purchased" should be ignored.

14. The Commissioner further argued that there was no evidence DSC was the taxpayer's agent in manufacturing the goods (as the taxpayer contended).

15. Hence, (so the Commissioner said) the business operations of the taxpayer and DSC were separate. There is no valid basis for treating any part of the taxpayer's profits to "belong to" DSC. Another way of stating the same point is there is no valid basis for treating any part of the profits as "arising in or derived from" DSC's business in the Mainland (adopting the terms of s. 14(1), Cap. 112 (the relevant provision is set out in para. 22 below)).

The Board's Fact Findings

16. The board's conclusion, as stated above, was that the taxpayer's appeal should be allowed.

17. Because these case-stated are premised "on the facts as found by the Board", it is essential to identify what the facts found by the board were. See, for example, similar observations in *CIR v Emerson Radio Corp* [1999] 2 HKLRD 671, 677; *ING Baring Securities (Hong Kong) Ltd v CIR* [2008] 1 HKLRD 412, para. 167.

18. The findings made by the board fall under the headings "Agreed Facts" (para. 2.1 to 2.18, case-stated (especially para. 2.2 to 2.5, 2.8 to 2.9, 2.10(a) to (b), (f) to (h) and 2.11 to 2.12 thereof)), and "Findings" (para. 10.1, 10.14 to 10.16 and 10.22 to 10.23, case-stated).

19. For ease of reference, the more important parts of those facts are summarized below:-

(1) the facts set out in para. 4 and 8 above;

(2) the taxpayer's books of account were consistent with DSC being its subsidiary;

(3) separate accounts were kept by the taxpayer and DSC and those of DSC recorded that there had been sale (of manufactured goods) and purchase (of materials) transactions with the taxpayer;

(4) the manufacturing process involving DSC was carried out in the following manner:-

(a) the taxpayer was primarily responsible for design, product testing and prototype production;

(b) purchases from third parties were concluded by the taxpayer. Sales work orders and production orders would then be prepared in Hong Kong and faxed to DSC;

(c) raw materials were purchased in Hong Kong then transferred to DSC according to the production schedule set in Hong Kong;

(d) quality assurance engineers and production control staff from the taxpayer would visit DSC to train and update DSC's staff;

(e) a deputy general manager, production manager, production controller and engineer would station in DSC to monitor and manage its operation;

(5) hence, the manufacturing process was still under the taxpayer's control. The taxpayer was able to enjoy the low production costs in the Mainland;

(6) the taxpayer financed DSC's operation by paying for the monthly processing fee. This took the form of payment for the price of goods the amounts of which were no greater than DSC's operating costs and overhead;

(7) processing agreements were concluded between the taxpayer and DSC annually;

(8) DSC was not the taxpayer' s agent:-

(a) neither DSC being the taxpayer' s subsidiary nor DSC acting wholly as directed by the taxpayer was determinative of this point;

(b) the dealings between them was by way of sale and purchase;

(c) DSC carried on its own business. It was a legal entity; it had its own work-force; it kept separate books of account and it paid processing fees to the taxpayer;

(d) the taxpayer did not have a permit to carry out manufacturing in the Mainland; hence, DSC could not have been empowered by it to do so;

(9) DSC had been carrying on import processing work when it dealt with the taxpayer:-

(a) DSC' s licence was solely for import processing work;

(b) the transfers of materials and goods between them were by way of sale and purchase;

(c) the legal effect of the licence, the invoices and the terms of CIF and FOB contracts could not be disregarded;

(d) the fact that title to the inventories still belonged to the taxpayer had been considered, but this was regarded as an internal matter between them;

(10) in view of the above, the taxpayer was carrying on a manufacturing business. Part of the profit from this business had its source in the Mainland because the taxpayer had also undertaken operations there:-

(a) the machinery, equipment, raw materials and technical know-how of DSC all originated from the taxpayer;

(b) Hong Kong staff was sent to DSC to monitor, train and supervise DSC' s staff;

(c) the deputy general manager stationed at DSC was employed by the taxpayer and on its payroll. So were the other 3 Hong Kong staff. They worked full time at DSC;

(d) although the dealings were in the form of sale and purchase, they were not agreed on at arm's length.

The board's finding summarized at para. sub-para. (10) above was apparently also based on:-

> "[the taxpayer] … providing DSC with design, technical know-how, management, training and supervision for the local work force and in supplying DSC with the manufacturing plant and machinery … ".

These were regarded as:-

> "… important operations [undertaken in the Mainland] and attributable to the profits in question … "

(para. 10.28, case-stated).

20. It is immediately apparent from the wordings of para. 19(10) above and the above quotes that the Commissioner's questions (set out in para. 2 above) are directed against them.

The Board's Underlying Approach

21. Although the board has not expressly said so in its decision, its decision to allow the taxpayer's appeal must have been premised on DIPN 21.

22. The relevant charging provision in Cap. 112 is s. 14(1). The material parts read:-

> "… profits tax shall be charged … on every person carrying on a … business ***in Hong Kong*** in respect of his assessable profits ***arising in or derived from Hong Kong*** for that year from such … business … " (emphasis supplied).

23. The relevant parts of DIPN 21 say:-

> "***Manufacturing Profits***
>
> …
>
> … where a Hong Kong company ***manufactures goods partly in Hong Kong*** and partly … in the Mainland, then that part of the profits which relates to the manufacture

> of the goods ***in the Mainland will not be regarded*** as arising in Hong Kong" (emphasis supplied) (para. 14 thereof).

The above paragraph is clearly concerned with a Hong Kong company which has been licensed to manufacture goods in the Mainland.

24. DIPN 21 also deals with Hong Kong companies which have not been licensed to do so:-

> "A Hong Kong ***manufacturing*** business, which ***does not have a licence*** to carry on a business in the Mainland, may enter into a ***processing or assembly arrangement*** with a ***Mainland entity*** … [which] is responsible for … manufacturing … the goods that are required to be exported to places outside the Mainland. The Mainland entity provides the factory premises, the land and labour. … [It] charges a processing fee and exports the completed goods … The Hong Kong manufacturing business normally provides the raw materials. It may also provide technical know-how, management, production skills, design, skilled labour, training and supervision … and the manufacturing plant and machinery … " (para. 15 thereof);
>
> "In law, the Mainland processing unit is a ***sub-contractor separate and distinct*** from the Hong Kong manufacturing business … However, recognizing that the Hong Kong manufacturing business is ***involved in the manufacturing activities*** in the Mainland … the Department is prepared to ***concede***, in ***cases of this nature***, that the profits on the sale of the goods … can be apportioned … generally … on a 50:50 basis" (emphasis supplied) (para. 16 thereof).

The words "on the sale of the goods" in para. 16, DIPN 21 must mean the sale by the Hong Kong business.

25. I pause to note that, as will be set out in more detail below, the phrase "in cases of this nature" in para. 16, DIPN 21 is important to the outcome of these case-stated.

26. For those Hong Kong companies which are not involved in the Mainland manufacturing process, DIPN continues to say:-

> "If … the manufacturing in the Mainland has been ***contracted to a sub-contractor*** (whether a related party or not) and ***paid for*** on an arm' s length basis, with ***minimal involvement*** of the Hong Kong business, the question of apportionment will not arise. For the Hong Kong business, this will not be a case of manufacturing profits but rather a case of trading profits … " (emphasis supplied) (para. 17 thereof).

27. Thus, what DIPN 21 intends is the provision of a tax concession in appropriate cases, even though profits tax might have been fully assessable if s. 14(1), Cap. 112 had been adhered to strictly.

28. If DIPN 21 (which is a concession of the Commissioner's part) had not been put in place, (and on a narrow reading of s. 14(1), Cap. 112) the taxpayer's profits tax position might have been much clearer: its business profits in Hong Kong might have been wholly chargeable to profits tax. This is because it has not been licensed to manufacture goods in the Mainland, and it has to purchase the manufactured goods from a Mainland entity [in this case, DSC]. The profits on sale of the goods supplied by DSC might have been treated as the trading profits of the taxpayer.

Correctness of the Board's Findings

29. When the parties' main dispute is examined in the manner set out under the heading "The Board's Underlying Approach" above, in order for the board to reach a correct conclusion, a number of matters must be correctly addressed.

30. Some of these matters are undisputed and expressly dealt with by the board (and correctly so):-

(a) is the taxpayer a Hong Kong manufacturing business? The answer is yes (s. 14(1), Cap. 112 and DIPN 21, para. 15 to 16) (the Commissioner appears to have reservations about this in his reply submissions, but this does not appear to be part of the case-stated);

(b) did the taxpayer have a licence to carry on a business in the Mainland? The answer is no (DIPN 21, para. 15);

(c) has the taxpayer entered into a processing or assembly arrangement with a Mainland entity which was responsible for manufacturing the goods for export? The answer is yes (DIPN 21, para. 15).

31. But the parties disagree as to whether the board has correctly addressed the following matters:-

(1) was the arrangement one *the nature of which* was the taxpayer was involved in DSC's manufacturing activities within the meaning of DIPN 21 (and if so, was the involvement only minimal) (DIPN 21, para. 16 to 17)?

(2) was the arrangement one where the manufacturing in the Mainland has been contracted to a sub-contractor and paid for on arm-length's basis (DIPN 21, para. 17)?

(3) if questions (1) and (2) above are answered in the taxpayer's favour, should there be an apportionment of profits (and if so, should it be at the usual 50:50 basis) (DIPN 21, para. 16)?

32. The correctness of the board's findings regarding the disputed matters will be dealt with below.

(a) The Taxpayer's Involvement in the Mainland Manufacturing

33. As stated above, the Commissioner's argument is almost totally based on the fact that the dealings between the taxpayer and DSC were being transacted in the form of sale (of raw materials to DSC) and purchase (of goods from DSC). It is said that, because of the form chosen, the taxpayer was not involved in the manufacturing activities of DSC.

34. With respect, I agree with the taxpayer that this is a wrong approach when deciding whether the concession provided by DIPN 21 is applicable to the taxpayer.

35. As stated above, the dispute revolves around the applicability of DIPN 21. Para. 16, DIPN states that, whilst in law the whole of the profits may be assessable (s. 14(1), Cap. 112), a tax concession will be given to:-

> "… [cases ***of the nature***] that [a] Hong Kong manufacturing business is ***involved in*** the manufacturing activities in the Mainland … the profits … can be apportioned … " (emphasis supplied).

Thus, the terms of DIPN itself place importance on *the nature of* the transaction, rather than its outward appearance. In short, substance should prevail over form.

36. Hence, when deciding whether there was involvement in the Mainland manufacturing activities, and whether the involvement is more than minimal, the board was correct in looking at the substance of the dealings rather than at the form. The facts (some of which are undisputed) already found by the board support its finding that there was more than minimal (in fact, far more than minimal) involvement on the taxpayer's part (see para. 19(1), (2), (4) to (6) and (10) above).

37. The parties' written submissions have addressed in length:-

(a) the difference between a "contract processing" (**來料加工**) arrangement and a "import processing" (**進料加工**) arrangement;

(b) whether DSC was the taxpayer's agent when carrying on its manufacturing activities in the Mainland.

Sub-para. (a) above will be dealt with under the next sub-heading "(b) Has the Manufacturing been Sub-Contracted to DSC ?".

38. Because the main dispute in these case-stated (as well as in the appeal to the board) concerns the applicability of DIPN 21, arguments concerning whether DSC should be treated as the taxpayer's agent in relation to DSC's manufacturing activities are misguided, and probably led to irrelevant and/or incorrect findings being made by the board (from the skeleton submissions kindly provided to me by counsel, it is clear arguments similar to those raised before me were raised before the board).

39. Both counsels' arguments and the board's findings relating to the question of agency were based on "conventional" legal principles laid down in agency law. But, as stated above, DIPN 21 intends to give a tax concession for cases falling within its terms, irrespective of the strict legal position. It focuses on the taxpayer's:-

> "… [involvement] in the manufacturing activities in the Mainland … " (para. 16, DIPN 21),

and not on the law of agency. In the context of these case-stated, an agency is where, although an act was done by DSC, the act is treated as that of the taxpayer.

40. One of the board's findings was that the dealings between the taxpayer and DSC was not at arm's length (para. 19(10)(d) above). There was (and is) ample basis in support of that finding (see para. 19(4) to (7) above).

41. It is probably because of such invitation that subjects like (1) the existence of an agency relationship between the taxpayer and DSC, and (2) the source of profits of the activities of the taxpayer and DSC, have been discussed in length and decided upon by the board.

42. It is also no surprise that the board ended up making findings which on their face appear to be entirely inconsistent; having found that there was no agency relationship and (as will be set out in more detail below) that there was an "import processing" arrangement between the taxpayer and DSC, the board concluded:-

> "… we are satisfied that the Taxpayer was carrying on a ***manufacturing business*** and the profits derived from its business were ***manufacturing profits*** and a certain part of its profits was ***sourced*** in the PRC" (emphasis supplied) (para. 10.24, case-stated).

43. The board is "correct" in all the findings summarized in para. 42 above within the *Edwards v. Bairstow* sense (see para. 70 below) (within their own respective confines). The

apparent inconsistencies arose from the failure to see that a proper determination of the appeal should not depend on legal concepts which have nothing to do with whether the taxpayer was "involved in the manufacturing activities" (the focus point of DIPN 21).

(b) Has the Manufacturing been Sub-Contracted to DSC ?

44. The Commissioner defines "contract processing" and "import processing" as follows:-

> (1) "contract processing" is where the Mainland enterprise does not take title to the raw materials that are imported for processing and assembly. The materials enter the Mainland on a consignment basis and title to all raw materials and finished products remains with the non-Mainland entity;
>
> (2) "import processing" is where the Mainland entity purchases raw materials and sells finished goods for its own account

(para. 21, Commissioner' s skeleton submissions).

45. The taxpayer does not dispute the above definitions. But it disputes the category into which the dealings between the taxpayer and DSC should fall.

46. What divides the parties is whether the issue should be determined purely by examining the documentation relating to those dealings; the Commissioner contends that it should be whereas the taxpayer contends otherwise.

47. The Commissioner relies on various judicial decisions for the proposition that the means through which one' s business is transacted (and the legal consequences flowing from such means) should not be completely ignored: *ING Baring Securities (Hong Kong) Ltd v. CIR* [2008] 1 HKLRD 412, para. 134; *Kwong Mile Services Ltd v. CIR* (2004) 7 HKCFAR 275, para. 9-10; *Nathan v. Federal Commissioner of Taxation* (1918) 25 CLR 183; *CIR v. Fleming* (1951) 33 TC 57.

48. For the reasons set out above, I am also of the view that, even if it were necessary to consider this issue, the true nature of the transactions should be determined according to substance rather than form.

49. But when the board concluded that the dealings between the taxpayer and DSC were "import processing" arrangements, it placed emphasis on their form:-

> (a) because DSC needed to comply with the licence granted by the Mainland authorities, the transfer of raw materials and finished goods between them had

to be documented by way of sale and purchase (para. 10.23, case-stated and para. 19(9) above);

(b) that the inventories were agreed to be owned by the taxpayer at all times was merely "internal matters" between them (para. 10.23, case-stated).

The other facts found by the board which are relevant to the nature of the transactions (see para. 19(4) to (7) and (10)(a) to (d) above) had not been taken into account by the board when deciding this issue.

50. The board has been led astray when so concluding. The emphasis should in fact be the other way round. As I concluded earlier, the real point which needs determination is the extent of the taxpayer's involvement (if any).

(c) Source of Profit

51. In the context of DIPN 21, the board has found in the taxpayer's favour as regards this aspect.

52. The reason for the finding has been analyzed above (see para. 19, 21 to 36 and 40 to 42 above).

53. Both the board's reasons for and its finding on this aspect are correct.

(d) Should There be An Apportionment and If So How Much?

54. It is unclear if the Commissioner also contends that, even if DIPN 21 is applicable, it is not for the board to take it into account when determining the taxpayer's appeal (and therefore not for this court to do so in the case-stated). If he so contends, I disagree with it.

55. One decision relied upon by the Commissioner is a previous board decision D36/06 (2006) 21 IRBRD 694. Insofar as the decision may also be relied on as authority for differentiating between "contract processing" and "import processing", the matter has already been dealt with above under the sub-heading "(b) Has the Manufacturing been Sub-contracted to DSC?".

56. It is unnecessary to set out the said decision in detail. Suffice it to say the board therein dismissed the taxpayer's appeal because it agreed with the Commissioner's approach (that is, form should prevail over substance).

57. But the board in D36/06 went further and said:-

> "… we remind ourselves earlier, [DIPN] have ***no binding force*** on the parties involved and also in law, where the parties are ***two entities separate and distinct*** from each other, the taxpayer is ***not entitled*** to an apportionment whether or not the processing arrangement is one of ***'contract processing' or 'import processing'***. The apportionment is a concession given by the [Commissioner] and it is only prepared [to do so] in the case of 'contract processing' … The function of the Board is to find the relevant facts and to apply [them] to the applicable law. It is ***beyond our bounds to award a concession*** which is not applicable under the law" (emphasis supplied) (para. 8.46 thereof).

58. What the board appears to be saying therein is: even if it should find in the taxpayer's favour on the facts, it would still have dismissed the taxpayer's appeal because it is not for the board to decide whether a DIPN 21 concession should be given.

59. With respect, the board's view is too restrictive. Apportionment of profits is indeed part of the revenue law in Hong Kong. As Lord Bridge observed in *CIR v. Hang Seng Bank Ltd.* [1991] 1 AC 306:-

> "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" (p. 323).

The above observation was repeated by Recorder Ribeiro SC (as he then was) in *Emerson Radio Corp v. CIR* [1999] 1 HKLRD 250, 274-5.

60. Further, s. 68(8)(a) and (b), Cap. 112 provide:-

> "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";
>
> "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" (emphasis supplied).

Thus, the board's powers under s. 68(8) appear to have been framed in wide terms.

61. It has not been suggested that DIPN 21 is *ultra vires* Cap. 112; nor is it suggested the Commissioner acts unlawfully when giving such a concession. Indeed, para. 21, DIPN 21 recognizes the absence of a specific provision in Cap. 112 for the apportionment of profits tax. But the Commissioner accepts an apportionment is permissible under Cap. 112 (see para. 21, DIPN 21).

62. According to DIPN 21, the general apportionment is to half the amount of assessable profits. There is no material in these case-stated to justify a departure from the norm.

Conclusion

63. By reason of the above matters, the questions posed in these case-stated will be answered as follows.

64. The answer to the Commissioner's question (a) is in the affirmative. In other words, on the facts found, the board was correct in law to conclude that the taxpayer's profits were manufacturing profits and a part of such profits was sourced in the Mainland.

65. The answer to the Commissioner's question (b) is in the affirmative. In other words, on the facts found, the board was correct to conclude that the taxpayer had undertaken operations in the Mainland and such operations were important operations and attributable to the profits in question.

66. The answer to the Commissioner's question (c) is in the affirmative. In other words, on the facts found, the board was correct in law to conclude that an apportionment of profits should be made on 50:50 basis.

67. The answers to the taxpayer's two questions are in the negative (because of the board's failure to heed the focus of DIPN 21). However, as explained above, these questions are in fact irrelevant to the taxpayer's appeal in any event.

68. Accordingly, in exercise of the power conferred by s. 69(5), Cap. 112, I will confirm the assessment determined by the board.

Other Matters

69. The taxpayer complains in its skeleton submissions that there was a lack of proper cross-examination by the Commissioner regarding some matters. As can be seen from the above paragraphs, it is unnecessary to consider the complaint in order to determine the case-stated. I will say a few words about it for completeness.

70. All of the questions posed in the two case-stated are questions of law based on facts actually found by the board. Any error of law which may arise therefrom can only arise in the manners outlined in *Edwards v. Bairstow* [1956] AC 14 (an authority relied upon by both parties):-

> "… without any … misconception [of the relevant law] appearing ex facie, it may be that the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. … So … too, there has been error in point of law. I do not think that it much matters whether this state of affairs is described as one in which there is ***no evidence to support*** the determination or as one in which the evidence is ***inconsistent with and contradictory of*** the determination, or as one in which the true and only reasonable ***conclusion contradicts*** the determination. Rightly understood, each phrase propounds the same test. For my part, I prefer the last of the three … " (emphasis supplied) (p. 36).

71. A complaint of lack of proper cross-examination concerns an irregularity in the hearing *process* before the board. I do not consider the opinion of this court can be sought about such a complaint when it forms no part of these case-stated.

72. Further, because the complaint has not been made in these case-stated, neither the board or the Commissioner has been given a proper opportunity to meet the complaint; it was only raised in the taxpayer' s skeleton submissions.

73. The right to be heard is one of the corner-stones of our system of civil justice. Ordinarily, such right can only be properly exercised when the party against whom a claim is advanced is informed of it in good time so that (a) the claim can be considered, and (2) any answer to the claim can be properly prepared. See my observations to similar effect in *China Map Ltd. and Others v. CIR* [2006] 3 HKLRD 719, para. 51-2.

74. In the context of a case-stated brought pursuant to the proviso to s.69, Cap. 112, this means the questions of law for the court of first instance should stated clearly and concisely, and not wider than are warranted by the facts: *Attorney General v. Leung Chi-kin* [1974] HKLR 269, 273; *Chinachem Investment Co. Ltd. v. CIR* 2 HKTC 261, 303; *CIR v. Inland Revenue of Review and Another* [1989] 2 HKLR 40,48.

75. The taxpayer contends that it is open for it to raise this complaint, relying on cases such as *Emerson Radio Corp* above ([1999] 1 HKLRD 250). But all that was said in that decision was:-

> "… I would have construed the requirement of s. 69(5)[, Cap. 112] that the Court 'shall hear and determine any question of law arising on the stated case' to mean

> *arising from the stated case comprising the facts, decision and questions formulated*" (p. 263) (per Recorder Ribeiro SC (as he then was));
>
> "… I have come to the conclusion that as a matter of law, it is ***permissible*** for a party to seek the opinion of the Court on questions additional to those framed in the case stated provided that such questions may fairly be said to ***arise out of the stated findings and decision of the Board***" (emphasis supplied) (p. 266).

76. The above passage cannot advance the taxpayer's argument because these case-stated were only about questions of law based "on the facts as found by the Board"; cross-examination (or its adequacy or otherwise) cannot fairly be said to arise out of the contents of these case-stated.

Costs Order

77. The parties agree that costs should follow the event. There will accordingly be a costs order that the costs of the case-stated are to be paid by the Commissioner to the taxpayer to be taxed if not agreed.

(Andrew Chung)
Judge of the Court of First Instance
High Court

Mr Paul Shieh, SC leading Mr Eugene Fung, instructed by Secretary for Justice, for the Appellant

Mr Chua Guan-Hock, SC, instructed by Messrs S K Lam, Alfred Chan & Co., for the Respondent