CACV 275/2008

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

CIVIL APPEAL NO. 275 OF 2008
(ON APPEAL FROM HCIA NOS. 3 and 4 OF 2007)

BETWEEN

COMMISSIONER OF INLAND REVENUE Appellant

and

DATATRONIC LIMITED Respondent

Before: Hon Tang VP, Stone J and Suffiad J in Court
Date of Hearing: 25 June 2009
Date of Judgment: 15 July 2009

J U D G M E N T

Hon Tang VP:

Introduction

1. This appeal concerns the profits tax assessment in respect of certain profits in the years of 1999/2000, 2000/2001 and 2001/2002.

2. The issue is whether the profits to be charged are profits arising in or derived from Hong Kong, section 14 Inland Revenue Ordinance, Cap. 112. Under section 14,

> "(t)he proper approach is to ascertain what were the operations which produced the relevant profits and where those operations took place?". *Commissioner of Inland Revenue v. HKTVB International Ltd* [1992] 2 AC 397 at 407C and D, and 409E. per Lord Jauncey.

3. Datatronic (Shunde) Corporation (**連達順德電子有限公司**) ("DSC") is a wholly-owned subsidiary of the Taxpayer. DSC has a factory in Shunde which commenced operation in September 1993. According to the information supplied by the Taxpayer to the assessor, and recorded in the case stated, DSC was a legal person carrying on a business of manufacturing electronic transformers, inductors, capacitors, components, etc. for export, and

> "(i) ' Separate books are kept and maintained by DSC in Mainland China. The transfer of raw materials from (the Taxpayer) were recorded as purchases in DSC' s books, while the transfers of finished goods to (the Taxpayer) were accounted for as export sales in DSC' s books.' " 2.10

4. Mr Paul Y. Siu, the chairman and ultimate controlling shareholder of the Taxpayer, said in his evidence before the Board of Review ("the board").

> "9.3 … that the raw materials from Hong Kong to Shunde and the finished goods from Shunde to Hong Kong were recorded as purchases and sales respectively in DSC' s books and accounts."

5. The following paragraphs in the case stated describe the arrangement between the Taxpayer and DSC:

> "<u>Source of Profits</u>
>
> 10.24 … In reaching this view, we have not treated any of DSC's activities as those of the Taxpayer nor accepted the submission of Counsel for the Taxpayer that the low production and labour costs in the PRC was the effective cause of the Taxpayer's profits. However, we have found the following facts from the documents produced to us.
>
> 10.25 The Taxpayer was established in 1971 as a manufacturer and exporter of electronic components. Between 1983 and 1993 the Taxpayer had a part

of its products manufactured by No.2 Plastic Plant in Daliang Town in the PRC. The Taxpayer provided No.2 Plastic Plant with all the machinery, equipment, raw materials and technical know-how. Between the same period the Taxpayer entered into contracts for Processing and Assembly with Shunde Light Industrial Import & Export Company Limited [' Shunde'] whereby ' Shunde' agreed to process materials from the Taxpayer and the Taxpayer provided ' Shunde' with the necessary equipments and tools for the processing works. The processing unit was No.2 Plastic Plant. On 10th July 1993, Equipment checklists were prepared by No.2 Plastic Plant showing items of machinery, equipments and articles owned by the Taxpayer with the respective locations storing such items. The establishment of DSC was approved on 23rd August 1993 and the Certificate of Approval was issued on 28th August 1998. In this Certificate of Approval, it was stated that the period of business is for 30 years. The Business Licence was dated 1st September 1998 in which it was stated that the period of business was from 2nd September 1993 to 2nd September 2023. Processing and Supplemental Agreements were entered into by DSC and the Taxpayer on 1st December 1998, 4th December 1998, 1st December 1999, 2nd December 1999, 2nd December 2000 and 4th December 2000 respectively.

10.26 Basing on the aforesaid facts coupled with the oral evidence from the witnesses and other documentary evidence produced to us, we have found the following additional facts.

10.27 The Taxpayer initially had a part of its products processed by No.2 Plastic Plant in the PRC. When No.2 Plastic Plant undertook processing works on behalf of the Taxpayer, the Taxpayer provided it with all the machinery, equipment, raw materials and technical know-how. The Taxpayer also sent staff members to be stationed at No.2 Plastic Plant to monitor the processing works. It trained and supervised the staff and labour of No. 2 Plastic Plant in respect of the processing works carried out on its behalf. Upon the establishment of DSC in 1993, the plant and machinery owned by the Taxpayer at No. 2 Plastic Plant were transferred to DSC for DSC's use. Mr Wong, at the beginning of his employment with the Taxpayer, was assigned to and stationed at No. 2 Plastic Plant to supervise and monitor the processing works of the Taxpayer there. When DSC was established, instead he was assigned to and stationed at DSC in Shunde. He had always been employed by the Taxpayer and was never employed or remunerated by DSC. While he was stationed at DSC, even though he was the deputy general manager of DSC and represented DSC in certain matters, such as signing the Processing Agreements and Supplemental Agreements and in

liaising with the PRC authorities, he nonetheless remained the employee of the Taxpayer and continued performing duties on behalf of the Taxpayer at DSC in Shunde as he did at No.2 Plastic Plant, such as supervising and monitoring the processing works carried out on behalf of the Taxpayer. There were other employees of the Taxpayer seconded to DSC, namely, Wong Kwok Yuk - production controller, Tam Chun Cheung -production manager and Law Wai Kai engineer. These employees of the Taxpayer were stationed at DSC in Shunde and save for Mr Law who was in charge of technical matters, were not required to attend the Taxpayer's office in Hong Kong. They spent full-time at DSC. Mr Law was required to attend occasionally the Hong Kong office of the Taxpayer to learn new techniques when a new product was launched. They were under the payroll of the Taxpayer. They supervised DSC's work force in the production of the goods ordered by the Taxpayer's customers. The four staff members of the Taxpayer, save for Mr Wong who also discharged duties on behalf of DSC, discharged their duties on behalf of the Taxpayer at DSC. Processing Agreement and Supplemental Agreement were entered into by the Taxpayer and DSC whereby the Taxpayer agreed to provide raw material, training, supervision of labour, design, technical know-how, product specifications and quality control standards, and training and supervision of local staff in the PRC. The Taxpayer did perform the obligations on its part under the Processing Agreements and Supplemental Agreements. The design and technical know-how development were carried out in Hong Kong and such design and technical know-how were supplied by the Taxpayer to DSC for processing works carried out by it for the Taxpayer. The supply of raw materials from the Taxpayer to DSC was in the form of sale of the raw materials by the Taxpayer to DSC and the finished goods supplied by DSC to the Taxpayer was in the form of purchase by the Taxpayer from DSC. The price of the finished goods paid for by the Taxpayer represented more or less the expenses incurred by DSC, after offsetting the price of the raw materials supplied by the Taxpayer to DSC. The transactions between them were not at arm's length.

6. Before the Board of Review, the Taxpayer claimed that:

(1) DSC' s activities in the Mainland were carried out for the Taxpayer and on its behalf such that DSC' s activities in the PRC were carried out for the Taxpayers and on its behalf, and that DSC' s activities were attributable in law to the Taxpayer as principal (the agency point).

(2) alternatively, it came within the commissioner's concession in the Departmental Interpretation and Practice Notes No. 21 (Revised) ("DIPN 21"), and the Taxpayer was entitled to a 50/50 apportionment of such profits

(3) alternatively, apportionment generally on the basis that the profits were partly made in the mainland

7. The Board of Review decided against the Taxpayer on the agency point. It held:

"10.15 As admitted by Counsel for the Taxpayer, the Taxpayer and DSC are two separate legal entities and they had their own separate business operations. We find that there is clear evidence that DSC was carrying on its own business operations at the material times. DSC was established on 2nd September 1993 as a wholly foreign-owned enterprise; it was a legal person carrying on a business of manufacturing electronic transformers etc for export; it owned a factory in Guangzhou; it kept and maintained separate books of accounts; it had its own work-force; and it carried out the processing works and charged the Taxpayer a processing fee in return. One of the witnesses also told us that the processing fees of DSC were maintained at a level whereby substantial profits tax would not be payable in the PRC. This answer is a clear indication that the profits of DSC were treated as its own and not those of the Taxpayer. …

10.16 Finally, for the existence of an agency relationship, the general principle of law is that whatever a person has power to do himself he may do by means of an agent, and conversely, what a person cannot do himself he cannot do by means of an agent. In the present case, the Taxpayer did not have a licence to carry out processing works in the PRC and thus it could not possibly empower DSC as its agent to carry out processing works on its behalf. On the basis of the aforesaid, we come to the conclusion that there was no agency relationship between the Taxpayer and DSC."

8. In relation to DIPN 21, on the question whether the arrangement between the Taxpayer and DSC was import processing or contract processing, the board agreed with the commissioner that the transactions between the Taxpayer and DSC were by way of import processing. It is common ground that:

"(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"

9. It then concluded:

"10.22 Having considered carefully the oral and documentary evidence before us and also the submissions on behalf of both parties, we have reached the conclusion that DSC was carrying on import processing transactions with the Taxpayer.

10.23 We have reached this conclusion for the following reasons. It is a fact which is also acknowledged by the Taxpayer itself that the business licence granted to DSC was an import processing licence. As the licence was an import processing licence, in order to comply with the rules and regulations applicable to import processing business, the transfers of raw materials and finished products between the Taxpayer and DSC had to be dealt with by way of sales and purchases. Mr. Sheung also gave evidence that he recalled that DSC, being a wholly foreign-owned enterprise, was at the material times unable to obtain a formal contract processing licence from the PRC government. Thus unless the rules and regulations were complied with and the business was transacted by way of import processing, no business could have been transacted between DSC and the Taxpayer. …"

10. Para. 15 of DIPN 21, in terms, refer to "a processing or assembly arrangement". The relevant paragraphs in DIPN 21 are:

"5. <u>DIPN 21</u>

'**Manufacturing Profits**

……

15. 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. Under these arrangement, the Mainland entity is responsible for processing, manufacturing or assembling the goods that are required to be exported to places outside the Mainland. The Mainland entity provides the factory premises, the land and labour. For this, it charges a processing fee and exports the completed goods to the Hong Kong manufacturing business. 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 for the locally recruited labour and the manufacturing plant and machinery. The design and technical know-how development are usually carried out in Hong Kong.

16. In law, the Mainland processing unit is a sub-contractor separate and distinct from the Hong Kong manufacturing business and the question of apportionment strictly does not arise. However, recognizing that the Hong Kong manufacturing business is involved in the manufacturing activities in the Mainland (in particular in the supply of raw materials, training and supervision of the local labour) the Department is prepared to concede, in cases of this nature, that the profits on the sale of the goods in question can be apportioned In line with paragraphs 21-22 below, this apportionment will generally be on a 50:50 basis.

17. If, however, 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. Profits of the Hong Kong business will be calculated by deducting from its sales the costs of goods sold, including any sub-contracting charges paid to the sub-contractor in the Mainland The taxation of such trading profits will be determined on the same basis as for a commodities or goods trading business."

11. However, the Board allowed the Taxpayer's appeal because it was:

"10.24 … 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. In reaching this view, we have not treated any of DSC's activities as those of the Taxpayer nor accepted the submission of Counsel for the Taxpayer that the low production and labour costs in the PRC was the effective cause of the Taxpayer's profits. However, we have found the following facts from the documents produced to us."

12. Those facts can be found in 10.25 to 10.29 of the case stated. 10.25 to 10.27 have been quoted in para. 5 above. We set out 10.28 and 10.29 below.

"10.28 On the basis of the aforesaid finding of facts, we conclude that in 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, the Taxpayer had also undertaken operations in the PRC and those operations were important operations and attributable to the profits in question. Since that part of profits was sourced outside Hong Kong, the same is thus not chargeable to tax.

10.29 Paragraphs 21 and 22 of DIPN 21 state that the Inland Revenue Department accepts that, notwithstanding the absence of a specific provision for apportionment of profits in the Ordinance, there are certain situations in which an apportionment of the chargeable profits is appropriate. One of those situations is of manufacturing profits. While the Department does not consider that apportionment will have a wide application, it believes that where apportionment is appropriate, it will, in the vast majority of cases, be on a 50:50 basis. In line with paragraphs 21 and 22 of DIPN 21, we consider that in the present case the apportionment of profits on a 50:50 basis is appropriate under the circumstances. We take this view because a high percentage of the Taxpayer's profits did come from the sale of the finished goods from DSC, while a large part of the Taxpayer's operations which contributed to the profits in question also took place in Hong Kong, thus rendering the apportionment at 50:50 basis appropriate."

13. As will have been noted, the Board relied on paras. 21 and 22 of DIPN 21 which provide:

"**Apportionment of Profits**

21. The Department accepts that, notwithstanding the absence of a specific provision for apportionment of profits in the Ordinance, there are certain situations in which an apportionment of the chargeable profits is appropriate. The example of manufacturing profits has already been stated above. A further example is service fee income where the services are performed partly in Hong Kong and partly outside.

22. Although the Department accepts that apportionment is permissible under the Ordinance, it does not consider it will have a wide application. The Department believes that where apportionment is appropriate it will, in the vast majority of cases, be on a 50:50 basis. Further, it will be necessary to scale down claims for general expenses of the business which contribute indirectly to earning both the Hong Kong and offshore profits. This should be done in the ratio that offshore profits bear to total profits. General expenses in this context refer to all indirect expenses. Requests to re-open previous year

assessments to permit apportionment will not be entertained (section 70A - prevailing practice)."

Case stated

14. By letter dated 10 October 2006 the Commissioner requested the Board state a case for the opinion of the Court of First Instance pursuant to section 69. By letter dated 11 October 2006, the Taxpayer made a cross application to state a case.

15. The relevant questions are:

"Questions Formulated by the Commissioner

(a) Whether, on the facts as found by the Board, the Board was correct in law in concluding in paragraph 10.24 above 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 in paragraph 10.28 above 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 in paragraph 10.29 above that an apportionment of profits should be made on a 50:50 basis.

Question Formulated by the Taxpayer

(d) Whether, on the facts as found by the Board, the Board was correct in concluding in paragraphs 10.16, 10.22 and 10.23 above 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."

16. Chung J answered those questions 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."

Chung J

17. The learned judge took the view that:

"35. … the dispute revolves around the applicability of DIPN 21. …" para. 35.

He held DIPN 21 that:

"39. … intends to give a tax concession for cases falling within its terms, irrespective of the strict legal position. …"

And that:

"48. … the true nature of the transactions should be determined according to substance rather than form."

The Appeal

18. This is the Commissioner's appeal.

Section 14

19. With respect, whether profits tax is payable is governed by section 14. Profits tax is payable in respect of profits which arose in or were derived from Hong Kong. If under section 14 no profits tax is payable DIPN 21 is irrelevant. We will deal later with the effect of DIPN 21 if profits tax is otherwise payable under section 14.

20. *Kwong Mile Services Ltd v. Commissioner of Inland Revenue* [2004] 7 HKCFAR 275 is the leading authority on section 14. However, it is unnecessary to refer to the judgment of Bokhary PJ (in which the other members of the court concurred) since its effect has been summarised by Ribeiro PJ in *ING Baring Securities (Hong Kong) Ltd v CIR* [2007] 10 HKCFAR 417. Ribeiro PJ said:

> "38. In *Kwong Mile Services Ltd v Commissioner of Inland Revenue*, applying the abovementioned authorities, this Court noted the absence of a universal test but emphasised ' the need to grasp the reality of each case, focusing on effective causes without being distracted by antecedent or incidental matters.' The focus is therefore on establishing the geographical location of the taxpayer' s profit-producing transactions themselves as distinct from activities antecedent or incidental to those transactions. Such antecedent activities will often be commercially essential to the operations and profitability of the taxpayer' s business, but they do not provide the legal test for ascertaining the geographical source of profits for the purposes of section 14."

21. Mr Paul Shieh, appearing with Mr Eugene Fung, submitted the logical consequence of the finding that the arrangement between the Taxpayer and DSC was by way of import processing is that the Taxpayer's profit-making transactions consisted of purchasing goods from DSC and then re-selling them at a profit. These activities took place in Hong Kong. DSC was a seller. Whatever work undertaken by the buyer (the Taxpayer) to assist the seller in preparing the goods and supplying them to the buyer, even though commercially essential to the operations and profitability of the buyer' s business, are merely antecedent or incidental to the transactions which generated the profits.

22. Mr Shieh also submitted that instead of concentrating on the wording of DIPN 21 and the notion of substance over form, what the learned judge should have done was to ascertain what were the profits' producing transactions and where they took place.

23. With respect, we agree with Mr Shieh.

24. The Board has found that DSC manufactured the products which were sold to the Taxpayer. This is a finding of fact. With respect, it is plainly right. We can see no basis upon which the finding can be overturned.

25. The board said:

> "<u>Source of Profits</u>
>
> 10.24 The broad guiding principle on source of profits is to see what the taxpayer had done to earn its profits and where he had done it. … Having carefully

> considered the relevant law, all the documentary and oral evidence and the submissions for and on behalf of the parties, 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. In reaching this view, we have not treated any of DSC's activities as those of the Taxpayer nor accepted the submission of Counsel for the Taxpayer that the low production and labour costs in the PRC was the effective cause of the Taxpayer's profits. However, we have found the following facts from the documents produced to us."

26. It was the failure on the part of the board to concentrate on the profit-making transactions which resulted, with respect, in its wrong conclusion. The matter could be tested in this way. Suppose a company in Hong Kong sells raw material at cost to an unrelated factory in the Mainland so that they would be used by the unrelated factory to produce the product which, in turn, was sold to the Hong Kong company, which then sold the product in Hong Kong at a profit. Suppose the finished product was purchased by the Hong Kong company at $2 and then resold at $3, the profit of $1 would be attributable to its sale of the finished product in Hong Kong. Let us further suppose that to ensure the product' s quality, the Hong Kong company not only supplied the raw materials at costs but had also posted a number of staff to the mainland factory to provide technical or other assistance as may be necessary. We do not believe that that would make any difference. Nor, for that matter, the fact that the mainland factory happened to be a wholly-owned subsidiary of the Hong Kong company, and as such the Hong Kong company was able to procure the wholly-owned subsidiary to sell its product to the Hong Kong company at cost.

27. In this context, it is necessary to bear in mind the observation of Millett NPJ in *ING Baring Securities*:

> "134. … But I cannot accept the proposition that, in the case of a group of companies, "commercial reality" dictates that the source of the profits of one member of the group can be ascribed to the activities of another. The profits in question must be the profits of a business carried on in Hong Kong. No doubt a group may for some purposes be properly regarded as a single commercial entity. But for tax purposes in this jurisdiction a business which is carried on in Hong Kong is the business of the company which carries it on and not of the group of which it is a member; the profits which are potentially chargeable to tax are the profits of the business of the company which carries it on; and the source of those profits must be attributed to the operations of the company which produced them and not to the operations of other members of the group.

28. We cannot accept the submission of Mr Chua, appearing for the Taxpayer, that the invoices and other documents showing that the transactions between the Taxpayer and DSC were

by way of sale (e.g. sale of raw materials by the Taxpayer to DSC and the finished product by DSC to the Taxpayer), were only produced for customs purposes and were unreal. One might equally say that the internal documents relied on by the Taxpayer were prepared for the purpose of profits tax computation in Hong Kong and unreal. In any event, the Board has taken all relevant matters (including those internal documents) into consideration, and there is no basis upon which one could overturn its conclusion that DSC was *not* the Taxpayer's agent in the mainland, that DSC was manufacturing on its own account, and that DSC then sold its product to the Taxpayer.

29. With respect, the Board has confused the technical assistance provided by the Taxpayer as the profit-producing transactions.

30. The learned judge was of the view that the Board's decision to allow the Taxpayer's appeal must have been premised on DIPN 21. The Board referred in terms to paras. 20 and 21 of DIPN 21 which is quoted above. We do not believe paras. 20 and 21 are helpful. With respect to the Board we believe it has failed to properly apply *Kwong Mile*. The relevant profits were made on the sale of the products. The fact that because of the Taxpayer's connection with DSC it was able to buy the products cheaply or at cost would not change the nature of the transaction. Nor that because of its technical assistance DSC was able to produce products which the Taxpayer could sell at a profit.

31. The learned judge recognized that on a narrow reading of section 14, the assessed profits tax might have been payable. He said:

> "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."

32. The commissioner submitted that DIPN 21 does not have the force of law and is not binding on the board or the court. We agree the charging session is section 14, and that DIPN 21 has no legal effect. In any event, DIPN 21 does not apply to import processing as opposed to contract processing. We do not believe one is entitled to stretch the concession. Also, this is not a case where for some administrative law reason effect should be given to DIPN 21. No such reason has been advanced.

33. The learned judge then proceeded to construe DIPN 21 and he rejected the commissioner's argument, which he said was that:

> "33. … because of the form chosen, the taxpayer was not involved in the manufacturing activities of DSC."

34. DSC was the Taxpayer's wholly-owned subsidiary, but it was a separate legal entity and the fact that its dealings with the Taxpayer were not at arm's length would not detract from the reality of the legal effect of the transactions.

35. The assessable profits were generated by the Taxpayer selling the finished products bought from DSC. The Taxpayer did not make the profit manufacturing in the mainland. It does not matter that it was able to have the products manufactured cheaply in the Mainland because its wholly-owned subsidiary could be procured to do it at a rate which would result in more profit being made by the Taxpayer in Hong Kong. The manufacturing was done by DSC. The Board has so found and that is substance not form. The Taxpayer's activities in the mainland were merely antecedent or incidental to the profit-generating activities.

36. Mr Chua relied on the finding by the Board that the Taxpayer was a manufacturer. But the essential findings by the Board was that DSC was not the taxpayer's agent and that the manufacturing activities carried on by DSC were not the activities of the Taxpayer. Where, with respect, the Board has gone wrong, was to have failed to have proper regard to *Kwong Mile* and *ING Baring* when it mistook the Taxpayer's antecedent or incidental activities as the "profit-producing transactions". The profit-producing transactions were the purchase from DSC and subsequent sale by the Taxpayer.

37. We would answer the questions quoted in para. 15 above as follows:

(a) No.

(b) No.

(c) No.

(d) (i) Yes.

(ii) Yes.

38. For the above reasons, we allow the appeal with costs.

Hon Stone J:

39. I agree.

Hon Suffiad J:

40. I agree.

(Robert Tang)	(William Stone)	(A.R. Suffiad)
Vice-President	Judge of the Court of First Instance	Judge of the Court of First Instance

Mr Paul Shieh, SC & Mr Eugene Fung, instructed by Secretary for Justice, for the Commissioner/Appellant

Mr Chua Guan-hock, SC & Mr Jonathan Chang, instructed by Messrs S.K. Lam, Alfred Chan & Co., for the Taxpayer/Respondent