

Case No. D13/21

Profits tax – source of profit – profit-producing transactions vs activities antecedent or incidental to those transactions – ‘totality of facts’ principle – frivolous and vexatious appeal – sections 2, 14(1), 68(4), (8) and (9), Part 1 of Schedule 5 of the Inland Revenue Ordinance (‘the IRO’).

Panel: Chui Pak Ming Norman (chairman), Chung Koon Ying, Louis and Ng Cheuk Ping, Charmaine.

Date of hearing: 24 June & 2 September 2021.

Date of decision: 17 December 2021.

The Appellant was incorporated as a private company in Hong Kong. The Appellant’s office in Hong Kong was responsible for administration, sale, procurement, installation works and backup. The Appellant also had a factory office (‘City E Office’) in City E, the Mainland, which was responsible for storage of inventories, procurement of material, production and arrangement of delivery of final products.

At the relevant times, Mr A was the Appellant’s Position AA. The Subject Sales were made to Company B. The sales were negotiated and confirmed with Company B during Mr A’s and Mr J’s visit to City C, Country D. Except for a quotation, no agreement had been entered into between the Appellant and Company B. The Company B sent the Appellant the Purchaser Order No XXXX dated 14 December 2016, which was signed by both Company B and the Appellant. This Purchase Order consisted of seven pages, which set out details of items, the number thereof, the unit price and the contract amount.

The Estimated Assessment Demanding Final Tax for 2016/17 and Notice for Payment of Provisional Tax for 2017/18 issued to the Appellant by the Inland Revenue Department dated 1 March 2018, showed Assessable Profits of HK\$360,000 with Tax Payable thereon of HK\$39,400 (‘Profits Tax Assessment’). The Appellant lodged its objection to the aforesaid assessment, on the strength of excluding offshore profits of \$1,257,944 (‘the Subject Profits’). Having considered the objection, the Acting Deputy Commissioner of Inland Revenue issued his determination dated 8 January 2021 (‘Determination’) on the objection whereby the assessable profits of HK\$360,000 stated in the Profits Tax Assessment with tax payable thereon of HK\$39,400 was reduced to assessable profits of HK\$145,241 with tax payable thereon of HK\$5,991 (‘Revised Profits Tax Assessment’). This appeal was brought by the Appellant on 5 February 2021 under section 66 of the IRO against the Determination.

Held:

1. The Court should consider, not of the operations which produced the profits in question, but more narrowly of the operations of the taxpayer which produced them. In determining the question of source of profit, one should only focus on the effective causes without being distracted by antecedent or incidental matters. What constituted activities antecedent or incidental to the profit-producing transaction was a question of fact (ING Baring Securities (Hong Kong) Ltd v CIR (2007) 10 HKCFAR 417, CIR v Datatronic Ltd [2009] 4 HKLRD 675 considered).
2. The Appellant had to attend site visits, site measurements and preparation for electricity wiring plans for motors. Such activities were activities antecedent or incidental to the sale of the blinds under the supply agreement ('Supply Agreement'), which should not be regarded as the Appellant's profit-generating activities. The profit-generating activities undertaken by the Appellant was the acquisition of and the sale or supply of blinds to the Company B pursuant to the Supply Agreement.
3. The Board found that in terms of money, more than 90% of the materials for production of the ordered items under the Supply Agreement were acquired in Hong Kong by the staff of the Appellant. Those parts were delivered to the City E Office for processing or manufacturing.
4. The City E Office (or his licensed staff holding the City E Office) could not possibly be the Appellant's agent. There did not exist any agency relationship between the Appellant and the City E Office as claimed by the Appellant. The manufacturing activities of the City E Office, being non-agent third parties, should not be regarded as the manufacturing activities of the Appellant. Such activities were merely the Appellant's activities antecedent or incidental to the profit-generating activities. Such activities should not be regarded as the Appellant's own profit-generating activities (ING Baring Securities (Hong Kong) Ltd v CIR (2007) 10 HKCFAR 417, CIR v Datatronic Ltd [2009] 4 HKLRD 675, and CIR v CG Lighting Ltd [2010] 3 HKLRD 110 followed).
5. The Appellant had not engaged in any manufacturing activity whether in Hong Kong or the Mainland. One of the activities that produced profits to the Appellant was its acquisition of blinds manufactured by the City E Office for trading purposes. The Board concluded that the City E Office was an entity separate from the Appellant and the Appellant acquired the blinds from the City E Office for the purpose of supplying them to the Company B.
6. Having considered the amount of installation charges and the work in relation to installation undertaken by the Appellant itself, the provision of guidance of installation of blinds and training to the local worker at site by two to three experienced technicians of the Appellant were antecedent or incidental

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activities which should not be regarded as the Appellant's own profit-generating activities.

7. Applying the 'totality of facts' principle, having considered all the circumstances and all the Appellant's activities which generated the Subject Profits and the evidences, it was the Board's conclusion that the Appellant's operations were to acquire blinds and the associated items or automatic railings from the City E Office and to supply or sell them to Company B pursuant to the Supply Agreement. Both the acquisition and sale and purchase of blinds and accessories were done in Hong Kong which generated the Subject Profits. The installation of the blinds and railings at City C was incidental to the said sale and purchase. The claim that the Subject Profits was generated offshore was rejected. The Subject Profits arose in or were derived from Hong Kong (CIR v Magna Industrial Co Ltd [1997] HKLRD 173, Consco Trading Co Ltd v Commissioner of Inland Revenue [2004] 2 HKIRD 818 followed).
8. The Appellant had failed to discharge, under section 68(4) of the IRO, its onus of proving that the assessment appealed against was excessive or incorrect. The appeal was dismissed and the Revised Profits Tax Assessment was hereby confirmed. In the Board's view, there was no reasonable prospect of success in the appeal. The Appellant knew very well that there were no good grounds to appeal. This was just a frivolous and vexatious exercise on the part of the Appellant.

Appeal dismissed and costs order in the amount of \$25,000 imposed.

Cases referred to:

Commissioner of Inland Revenue v Hang Seng Bank Limited [1991] 1 AC 306
Commissioner of Inland Revenue v HK-TVB International Limited [1992] 2 AC 397
ING Baring Securities (Hong Kong) Ltd v Commissioner of Inland Revenue (2007) 10 HKCFAR 417
Commissioner of Inland Revenue v CG Lighting Ltd [2010] 3 HKLRD 110
Commissioner of Inland Revenue v Magna Industrial Co Ltd [1997] HKLRD 173
Consco Trading Co Ltd v Commissioner of Inland Revenue [2004] 2 HKIRD 818
D7/14, (2014-15) IRBRD, vol 29, 436
D16/17 (2018-19) IRBRD, vol 33, 281
Commissioner of Inland Revenue v Datatronic Ltd [2009] 4 HKLRD 675

Lo Man Mui, Ceiceily of Messrs Ceiceily Lo & Company, for the Appellant.
Cheung Ka Yung, Cheng Po Fung, and Wong Hoi Ling, for the Commissioner of Inland Revenue.

Decision:

Introduction

1. The Estimated Assessment Demanding Final Tax for 2016/17 and Notice for Payment of Provisional Tax for 2017/18 issued to the Appellant by the Inland Revenue Department under Charge Number X-XXXXXXXX-XX-X, dated 1 March 2018, showed Assessable Profits of HK\$360,000 with Tax Payable thereon of HK\$39,400 ('Profits Tax Assessment').
2. The Appellant lodged its objection to the aforesaid assessment. Having considered the objection, the Acting Deputy Commissioner of Inland Revenue issued his determination dated 8 January 2021 ('Determination') on the objection whereby the Profits Tax Assessment is reduced to assessable profits of HK\$145,241 with tax payable thereon of HK\$5,991 ('Revised Profits Tax Assessment').
3. This appeal is brought by the Appellant on 5 February 2021 under section 66 of the Inland Revenue Ordinance (Chapter 112 of the Laws of Hong Kong)('the IRO') against the Determination.

Grounds of Appeal

4. The grounds of the appeal raised by the Appellant in its Statement of the Grounds of Appeal are summarized as follows:
 - (a) The Appellant's business is by a tailor-made model (sic). Final value of sales amount will be adjusted whenever there has change of requirement of customer (sic).
 - (b) Mr A was invited by Company B to City C, Country D¹ to visit the site and solicited the preliminary quotation after measuring the size and quantity of the items to be stated on the purchase order. After first visit during the period from 8 November 2016 to 15 November 2016, the Appellant sent a fee quotation in excel format to Company B to review. The purchase order no XXXX issued by Company B was by use of the framework of fee quote provided by the Appellant in excel form.
 - (c) After Mr A arrived in City C, Country D to meet with Company B's staff on 16 December 2017, Company B negotiated and finalized the proforma quotation and signed in City C. The purchase order no XXXX was based on the framework provided by Appellant in excel format sent on 14 December 2016. The purchase orders have been amended during Mr A's visit and with his approval on 16 December 2016.

¹ Hereinafter referred to as City C.

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- (d) The sales to Company B were related to providing sewing services, accessories and installation of blinds. All fabric had been provided by Company B. All relevant works were operated and concluded in City E² and City C. Copy of payroll of City E staff for sewing of the items of this job is enclosed for reference.
- (e) Staff in City E does not have right to order accessories for the job. They need to check the quantity of items needed for production and inform Hong Kong office to place order. Thus, decision of making order was made by City E, Hong Kong office is only to place order after receiving information from City E.
- (f) The Appellant hired 2 companies in overseas to perform the installation work with their staff in City C. Copies of the payment and invoices to installing company are enclosed for reference.

As the place of negotiation, was solicited as well as concluded outside Hong Kong, the Position AA of the Appellant considered the relevant income should be offshore income and not be subject to Hong Kong Profits Tax.

Agreed Facts of the Parties

5. The parties agreed the following facts, which shall form part of the facts of the Appeal:

- (1) The Appellant has objected to the Profits Tax Assessment raised for the year of assessment 2016/17. The Appellant claims that the assessment was excessive.
- (2)
 - (a) The Appellant was incorporated as a private company in Hong Kong in 1997.
 - (b) In the Profits Tax Return filed, the Appellant described its principal activities as trading of blind, curtain track and fabrics and provision of installation services.
 - (c) The Appellant's business address was Address F.
 - (d) At the relevant times, Mr A and Ms G were the Appellant's Position AAs.
 - (e) The Appellant closed its accounts on 31 March annually.
- (3) As the Appellant failed to file its Profits Tax Return for the year of assessment 2016/17 within the stipulated time, the Assessor raised on

² City E, the Mainland.

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the Appellant the following estimated Profits Tax Assessment for the year of assessment 2016/17 pursuant to section 59(3) of the IRO:

	\$
Assessable Profits	<u>360,000</u>
Tax Payable thereon (after tax reduction)	<u>39,400</u>

- (4) The Appellant, through Messrs Ceiceily Lo & Company ('the Representatives'), objected to the above assessment claiming that it was excessive.
- (5) To validate the objection, the Appellant filed its Profits Tax Return for the year of assessment 2016/17 together with the audited financial statements and tax computation for the year ended 31 March 2017.
- (a) In the return, the Appellant declared adjusted loss of \$1,112,703 after excluding offshore profits of \$1,257,944 ('the Subject Profits').
- (b) Subject Profits were computed as follows:

	\$
Sales for offshore operation at City C – Hotel H ('the Subject Sales')	3,099,947
<u>Less:</u> Cost of material	1,733,848
Air ticket	41,013
Hotel	5,081
Messing	6,641
Staff salary and allowance	<u>55,420</u>
Subject Profits	<u>1,257,944</u>

- (6) In reply to the Assessor's enquiries, the Appellant, through the Representatives, put forth, among others, the following information and contentions:

The Appellant's establishment

- (a) The Appellant's office in Hong Kong ('HK Office') was responsible for administration, sale, procurement, installation works and backup. The Appellant also had a factory office ('City E Office') in City E, the Mainland, which was responsible for storage of inventories, procurement of material, production and arrangement of delivery of final products. The Appellant did not have any subsidiary or associated company.

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- (b) Mr A, together with Mr J (sales manager) and Ms K (regional manager) handled offshore sales and coordination of sales transactions. Mr L (purchase manager) was responsible for procurement and had to travel to the City E Office frequently to monitor the inventories. Ms G was involved in administrative work in Hong Kong. Staff of the City E Office were mainly responsible for manufacturing of fabric blinds.
- (c) A breakdown of the Appellants' staff salary, allowance and Position AAs' fee for the year of assessment 2016/17, which showed the information of Mr A, Ms G and 37 other staff, comprising of 24 staff of the HK Office and 13 staff of the City E Office.

The Subject Sales

- (d) The Subject Sales were made to Company B. The sales were negotiated and confirmed with Mr M of Company B during Mr A's and Mr J's visit to City C, Country D. Except for a quotation, no agreement had been entered into between the Appellant and Company B.
- (e) The travel schedule of Mr A and Mr J regarding the Subject Sales:

<u>Date of travel</u>	<u>Staff involved</u>
8-15 November 2016	Mr A and Mr J
16-20 December 2016	
17-24 February 2017	
4-10 April 2017	Mr A

- (f) Breakdown of cost of material in Fact 5(b)

	<u>Name of supplier</u>	<u>Place of incorporation of the supplier</u>	<u>Material/ item</u>	<u>Cost</u>
				\$
(i)	Company N	The Mainland	Motor with parts	2,938
(ii)	Company P	Hong Kong	Tools for installation	14,609
(iii)	Company Q	Country R	Motor switch	534,889
(iv)	Company S	Hong Kong	Backbond fabric	117,014
(v)	Company T	The Mainland	Aluminum profiles	40,447
(vi)	Company U	Hong Kong	Accessory for blinds	970,747
(vii)	Company V	Hong Kong	Transport accessory from Hong Kong to City E Office	<u>53,204</u>
				<u>1,733,848</u>

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- (g) After completion of the manufacturing of blinds, Company B arranged collection and delivery to the site at City C, Country D. The Appellant engaged some Hong Kong freelance installation workers and overseas sub-contractors for the on-site installation works.
- (7) In support of the offshore claim, the Appellant also provided, among others, the following documents:
- (a) A copy of purchase order no XXXX dated 14 December 2016 (Appendix A) issued by Company B to the Appellant for the attention of Mr J, which was addressed to the Appellant in Hong Kong.
- (b) Copies of invoices issued by the suppliers in Fact (6)(j)(ii), (v), (vi) and (vii) (Appendices B1 to B4).
- (c) A copy of Mr A's passport.
- (d) Copies of invoice/ quotation from two overseas sub-contractors for installation works, together with outward remittance advices issued by Bank W showing the settlement of the invoices by the Appellant.
- (8) (a) Having reviewed the information and documents provided by the Appellant, the Assessor did not accept its offshore claim in respect of the Subject Profits.
- (b) The Assessor now considers that the Profits Tax Assessment for the year of assessment 2016/17 should be revised as follows:

	\$
Loss per return, Fact (5)(a)	(1,112,703)
<u>Add: Subject Profits, Fact (5)(a)</u>	<u>1,257,944</u>
Assessable Profits	<u>145,241</u>
Tax Payable thereon (after tax reduction)	<u>5,991</u>

The Hearing

6. At the hearing, the Appellant called its Position AA, Mr A to testify under oath on its behalf. Mr A was the only witness called by the Appellant.

7. Despite the direction given to the parties by the Board on 12 April 2021 *inter alia* that the Appellant was to file on or before 7 June 2021 witness statements of any witness whom the Appellant intended to call, the Appellant ignored the direction and failed to do so. Had Ms Lo, the sole proprietor or a partner of the Representatives ('Ms Lo') complied

with the direction, it would save a lot of the Board's time on hearing the evidence-in-chief of Mr A.

8. Two to three hours were spent on hearing Mr A's account of general operation of the Appellant's business. Such time would be saved if the Appellant reduced the same in a witness statement pursuant to the Board's direction.

Mr A's evidence

9. The gist of Mr A's evidence relating to the conclusion of the subject contract with Company B, which was the agent for a customer in Country D, a 6-star hotel operator and the fulfillment of the contract are as follows:

Supply Contract with Company B

- (1) As a Position AA of the Appellant, he was charged with the overall supervision of the Appellant which included sales, purchases and manufacturing and other procedures.
- (2) In or about November 2016, he received a phone call from an English company, Company B, whom he had no dealing before. He was invited to supply and install certain blinds to a six-star hotel in City C of Country D. He was sent a bill of quantity and specification by e-mail for quotation after the phone discussion. However, such bill of quantity and specification might not have been filtered by the ultimate user and the information provided was basic.
- (3) Mr A and Mr J, the Appellant's sales manager then flew to City C on 8 November 2016 to meet the representative of Company B and to discuss with them about the project. They stayed there until 15 November 2016. During their stay, he and Mr J met the hotel representatives as well. After the meeting, they understood more about the requirements of the customer. After Mr A's return from City C, he could prepare a preliminary quotation such as the rough unit price of the items required. It was preliminary because the site conditions would affect the materials to be used. Mr A quoted the example that different types of motors would be used to cope with the electricity power supplied to the site. He said the preliminary quotation was sent by e-mail in Hong Kong to Company B for consideration. He confirmed that he was in possession of a copy of the said preliminary quotation, but the same had not been produced to the IRD for their consideration.
- (4) After Mr A and Mr J returned to Hong Kong, they continued the negotiation with the Company B by several e-mails and a few phone calls. Mr A told the Board that he had no business dealing with this customer before. Mr A said he was in possession of such e-mails but such e-mails had not been produced to the IRD by the Representatives

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previously. Neither did he bring the same with him on the hearing date. Although he was invited to visit City C again to negotiate the supply contract further, he did not feel comfortable to do so until the counterparty gave him a deposit. Mr A explained that without a deposit being paid by the counterparty, he would suffer a loss in expenses incurred for air-tickets and accommodation in hotel in the event that no contract was eventually concluded.

- (5) Company B sent him a Purchase Order No XXXX dated 14 December 2016 by e-mail, which was compiled on the basis of the preliminary quotation given by him³. On or about 15 December 2016, the Appellant received a deposit of HK\$2.8 million from Company B. The subject contract was quite different from other supply contracts. In the subject contract, the Appellant needed to re-design at site in City C because sidetracks were missing from the purchase order. He needed to prepare the electricity wiring plans for the motors which were required to be integrated into the Room Control Unit of the hotel rooms. The Room Control Unit consisted of a Printed Circuit Board, which was part of a mini computer. The Appellant also needed to set the motors independently at each hotel room.
- (6) Since the payment of the deposit by Company B, Mr A felt it safe to travel again. He and Mr J flew to City C again on 16 December 2016. In this occasion he negotiated the supply contract further. When they arrived, Company B introduced the hotel owner (or developer), its M&E staff and three to four sub-contractors to them. The group then discussed the project further. They had visited the site and taken some photos. At that time, the windows in the hotel were not yet completed. They could not take measurements in this occasion. It necessitated them to visit City C again in future. They returned to Hong Kong on 20 December 2016.
- (7) After returning from City C, Mr A and his staff continued to discuss with the counterparty by e-mails and on phone, though the frequency was not much. Although he was the person in charge, his involvements in phone discussion and e-mails correspondences were minimal. All such communications were mainly conducted by Mr J. As such, he had not produced the e-mails to the Respondent for their consideration of the Appellant's objection.
- (8) Mr A and Mr J flew again to City C on 17 February 2017. On this occasion, they commenced the measurements of the window and checking of the electricity wirings. However, they could only take measurements on thirty percent (30%) of the rooms as about seventy percent (70%) of the rooms were not yet completed. After Mr A

³ Paragraph 4(b) of this Decision.

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returned from City C, he and his staff continued communicating with the counterparty by phone calls or e-mails. Mr A confirmed that he believed that there were not too many e-mails but such e-mails had not been provided to the Respondent for their consideration of the Appellant's objection.

- (9) Mr A flew to City C again on 4 April 2017. The purpose of visit was to conduct the site survey. He also installed a sample room to install the railings, motors, control units, blinds for end user's consideration. Upon their satisfaction of the sample, he then verified the measurements of rooms. After he returned to Hong Kong on 10 April 2017, he then asked the factory in City E to commence production. Mr A stressed that he would regard there was a contract made only after the samples were approved by the end user.
- (10) When asked what were the terms of the supply contract, Mr A replied that they were simply the supply and installation of electrical blinds. When asked how the contract was made, Mr A replied that the counterparty sent him a quotation by e-mail. When asked when the quotation was sent, Mr A confirmed that it was sent in December 2016.
- (11) When asked if he would confirm that there was a contract made in December 2016, Mr A said it was not completely so. When asked whether he would suffer a loss if he commenced the production of the products without a contract, Mr A confirmed that he would regard that there was a contract made only if the customer made the payment of deposit.
- (12) Mr A confirmed that Company B remitted a sum of HK\$2.8 million on or about 15 or 16 December 2016 as deposit. When asked if there was anything to sign after he received the deposit in December 2016, Mr A said large developers would only give a 'letter of intent' to confirm what would be required from the Appellant and to appoint the Appellant to handle the project. They did not necessarily sign the quotation prepared by the Appellant.
- (13) When asked if the 'letter of intent' was regarded as a binding document on the Appellant from his point of view, Mr A said he did not feel there was even a contract by then.
- (14) Mr A was referred to the signatures put on by Company B and the Appellant on the Purchase Order No XXXX. He was asked if he would regard a contract was made when he signed the Purchase Order and received the deposit paid by the counterparty. He then only admitted that he would regard the Appellant had a contract with the other party on 16 December 2016.

- (15) Mr A was evasive on the questions raised on how and when a binding supply contract was concluded. Mr A once stressed that a contract would not be made at an early stage because there were variations in a later stage. When asked what the Appellant would do if customers requested for variations, Mr A replied that he would send new quotations to clients again but they did not necessarily sign on the new quotations. They would only confirm by e-mails. Upon further enquiry, Mr A told the Board that he was not sure how to make variation orders and how the Appellant received money from customers because those works were handled by Mr J. He could not confirm until he had a chance of reading the record.

Orders for Materials to manufacture

- (16) In the subject supply contract, the fabrics were provided by the customers from which they produced the curtains or blinds. The Appellant needed only to order motors, railings and other parts for producing the final products for installation. Anything which could be obtained in the Mainland would be purchased by the City E Office in City E.
- (17) Since the City E staff did not know English, in respect of any parts or materials which were required from overseas company, the orders would be placed by the staff of the HK Office.
- (18) Although materials were ordered from Hong Kong suppliers or overseas suppliers, they were delivered directly to the factory in the Mainland. Mr A said although the purchase invoices were issued by Hong Kong suppliers to the Appellant, such purchases should not be regarded as the purchases by the Appellant because the money would be paid by the City E Office and the goods ordered would be delivered directly to the factory in the Mainland.

Manufacturing of Products

- (19) Mr A said all the products for this project were produced in the City E Office. The HK Office was not responsible for manufacturing. The staff of HK Office would liaise closely with the City E Office on customer's requirements.
- (20) The staff in HK Office would give instructions to the staff in City E Office regarding delivery of products. The head of the purchase department, Mr L, worked half of his time in Hong Kong and the other half in the City E Office. Mr L needed to travel to the Mainland to coordinate the purchase of materials for production and production itself.
- (21) Mr A confirmed that the Appellant did not have the business

registration license issued by the Mainland authority at the material time. The City E Office was set up by his staff who held the factory in his own name for the Appellant. To him, the City E Office was his agent. All the monthly expenses of the City E Office such as the staff's salary and costs of materials purchased would be charged back on the Appellant.

- (22) When asked how the City E Office made entries in its audited account, Mr A confirmed that auditing on its account was not necessary. The City E Office only engaged an accountant in the Mainland to do the tax report.

Installation of railing and blinds

- (23) The head of the project team in Hong Kong would be responsible for the installation work which included the preparation of the installation diagram and wiring instructions. He would also liaise with the installation workers. In the subject contract, he relied on overseas installation workers because the Appellant and its staff did not have the working permit to do the installation work. However, the Appellant did send two to three experienced installation technicians to City C to provide instructions and training to the installation workers there.
- (24) Before the site was handed over to the customer, Mr A would have a final check at site to ensure that the quality and standard of the products met the customer's requirement.

The Statutory Provisions relating to Profits Tax

10. The following provisions of the IRO are relevant in determining the Appeal taken by the Appellant:

(a) *The charging provision of profit tax*

- (i) The charging provisions for profits tax is section 14(1) of the IRO, which reads,

'(1) Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment ... on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.'

- (ii) The term ‘*Profits arising in or derived from Hong Kong*’ in section 14(1) of the IRO was defined in section 2 of the IRO as follows:

‘profits arising in or derived from Hong Kong (於香港產生或得自香港的利潤) for the purposes of Part 4 shall, without in any way limiting the meaning of the term, include all profits from business transacted in Hong Kong, whether directly or through an agent;’

(b) Burden of proof

The onus of proof in an appeal before the Board is provided in section 68(4) of the IRO which reads as follows:

‘The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.’

(c) Costs

Section 68(9) of the IRO provides *inter alia*:

‘Where under subsection (8), the Board does not reduce or annul such assessment, the Board may order the appellant to pay as costs of the Board a sum not exceeding the amount specified in Part 1 of Schedule 5⁴, which shall be added to the tax charged and recovered therewith.’

The Relevant Legal Principles

11. The Board is grateful to the Respondent for its submission of the following authorities, which illustrate the well-established legal principles relating to profits tax.

Charge of Profit Tax

12. In CIR v Hang Seng Bank Limited [1991] 1 AC 306, Lord Bridge at 318E-323B laid down the following principles on determining the source of profit:

‘Three conditions must be satisfied before a charge to tax can arise under section 14: (1) the taxpayer must carry on a trade, profession or business in Hong Kong; (2) the profits to be charged must be “from such trade, profession or business,” which their Lordships construe to mean from the trade, profession or business carried on by the taxpayer in Hong Kong; (3) the profits must be “profits arising in or derived from” Hong Kong. Thus the structure of the section presupposes that the profits of a business carried on

⁴ The amount specified in Part 1 of Schedule 5 of the IRO is HK\$25,000.

in Hong Kong may accrue from different sources, some located within Hong Kong, others overseas. The former are taxable, the latter are not.

... a distinction must fall to be made between profits arising in or derived from Hong Kong (“Hong Kong profits”) and profits arising in or derived from a place outside Hong Kong (“offshore profits”) according to the nature of the different transactions by which the profits are generated.

... the question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last analysis a question of fact depending on the nature of the transaction. It is impossible to lay down precise rules of law by which the answer to that question is to be determined. The broad guiding principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profit in question. If he has rendered a service or engaged in an activity such as the manufacture of goods, the profit will have arisen or derived from the place where the service was rendered or the profit making activity carried on. But if the profit was earned by the exploitation of property assets as by letting property, lending money or dealing in commodities or securities by buying and reselling at a profit, the profit will have arisen in or derived from the place where the property was let, the money was lent or the contracts of purchase and sale were effected.’

The Broad Guiding Principle

13. On the question of the source of profit, the principles laid down in Hang Seng Bank (*supra*) were expanded and applied in CIR v HK-TVB International Limited [1992] 2 AC 397. In HK-TVB, having discussed Hang Seng Bank (at 405G-407B), Lord Jauncey held at 407C that the guiding principle laid down by Lord Bridge could be expanded to read as follows:

‘One looks to see what the taxpayer has done to earn the profit in question and where he has done it.’

Lord Jauncey later stressed at 409E and G that the proper approach:

‘is to ascertain what were the operations which produced the relevant profits and where those operations took place.

...

In the view of their Lordships it can only be in rare cases that a taxpayer with a principal place of business in Hong Kong can earn profits which are not chargeable to profits tax under section 14 of the Inland Revenue Ordinance.’

It is important to look at the taxpayer's operations

14. In ING Baring Securities (Hong Kong) Ltd v CIR (2007) 10 HKCFAR 417, Lord Millett NPJ said that the Court should consider, not of the operations which produced the profits in question, but more narrowly of the operations of the taxpayer which produced them.

15. In relation to the operations of the taxpayer, Lord Millett PNJ in ING Baring further said at paragraph 129:

'The operations "from which the profits in substance arise" to which Atkin LJ referred must be taken to be the operations of the taxpayer from which the profits in substance arise; and they arise in the place where his service is rendered or profit-making activities are carried on. There are thus two limitations: (i) the operations in question must be the operations of the taxpayer; and (ii) the relevant operations do not comprise the whole of the taxpayer's operations but only those which produce the profit in question.'

16. In relation to 'the operations in question must be the operations of the taxpayer', Lord Millett PNJ said at paragraph 139:

'In considering the source of profits, however, it is not necessary for the taxpayer to establish that the transaction which produced the profit was carried out by him or his agent in the full legal sense. It is sufficient that it was carried out on his behalf and for his account by a person acting on his instructions. Nor does it matter whether the taxpayer was acting on his own account with a view to profit or for the account of a client in return for a commission.'

17. In relation to 'the relevant operations do not comprise the whole of the taxpayer's operations but only those which produce the profit in question', Ribeiro PJ in ING Baring stressed that in determining the question of source of profit, one should only focus on the effective causes without being distracted by antecedent or incidental matters. His Lordship said at paragraph 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 emphasized '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 s.14.'

18. The Court of First Instance in allowing the appeal by the Commissioner in CIR v CG Lighting Ltd [2010] 3 HKLRD 110, a case which also involved in cross-border manufacturing, accepted the Commissioner's submission, at paragraph 82, that:

'... where the profit-making transaction is a sale of goods in Hong Kong, any acts of the taxpayer participating in the manufacturing process of a non-agent third party are antecedent or incidental activities which should be disregarded in considering the source of the profits.'

Totality of Facts

19. The term '*totality of facts*' was accepted by Litton VP in CIR v Magna Industrial Co Ltd [1997] HKLRD 173 at 176F-I:

'In other words, one looks to see what the taxpayer has done to earn the profits and where he has done it. Obviously, the question where the goods were bought and sold is important. But there are other questions: For example: How were the goods procured and stored? How were the sales solicited? How were the orders processed? How were the goods shipped? How was the financing arranged? How was payment effected?'

This was, in essence, the Board of Review's approach. At para.7.23 of the stated case the Board said:

*This is a case of a trading profit and the purchase and the sale are the important factors. We place on record that we have included in our deliberations **all of the relevant facts** and not just the purchase and sale of the products. Clearly everything must be weighed by a Board when reaching its factual decision as to the true source of the profit. We must look at **the totality of the facts** and find out what the taxpayer did to earn the profit.*

***No criticism can be made of this approach.** Nor has it been suggested that the findings of fact made by the Board were not based upon evidence adduced before it.'* (Emphasis added)

20. In Consco Trading Co Ltd v Commissioner of Inland Revenue [2004] 2 HKIRD 818, Duty Judge A To said:

'To determine the source of profits, one must look broadly and consider all the circumstances and all the activities which generated the profits. Of course, the place where the goods were manufactured or where services were rendered is quite determinative of the source of profit, but not conclusive and it does not necessarily exclude the possibility that the source of profits could be outside that place. This is particularly so if manufacturing is just part of the activities which earned the profits.'

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21. In D7/14, (2014-15) IRBRD, vol 29, 436, the taxpayer contended that it had been operating under the mode of contract processing arrangement in the Mainland and therefore it should be entitled to a 50:50 apportionment of the assessable profits in all relevant years of assessment. The Board held that the taxpayer and City E Factory were not the same entity. In dismissing the Appeal, the Board said at paragraphs 37 and 38:

‘37. In any event, applying Datatronic, the manufacturing was done by the City E Factory. Since the Appellant did not have a licence to carry out processing works in the Mainland, it could not possibly empower the City E Factory as its agent to do so on its behalf. In the absence of such agency relationship, the manufacturing was done by the City E Factory in its own account. Various pieces of documentary evidence support this. Further, any acts of the Appellant participating in the manufacturing process of a non-agent, including purchase and delivery of raw materials to the City E Factory necessary for the manufacture of the finished goods, are antecedent or incidental activities, irrespective of whether such acts were done in Hong Kong or in the Mainland, which should be disregarded in considering the Appellant’s source of profits.’

22. In D16/17, (2018-19) IRBRD, vol 33, 281, the taxpayer contended that it was engaged in manufacturing watch cases and watch bands and straps and focused on OEM (Original Equipment Manufacturing) and that all business operations, including sales, purchases, and manufacturing, were completely carried out in the Mainland. However, the taxpayer has no business licence in the Mainland, and as such, factually or legally the Appellant could not operate any kind of business in the Mainland in its own capacity, nor can it argue that it operated a business in the Mainland through the Mainland Entities or its employees as its agents. The taxpayer’s purchases from and sales to its related companies in Hong Kong suggested that its profit are sourced in Hong Kong.

Profit-producing transactions vs activities antecedent or incidental to those transactions

23. What constitutes activities antecedent or incidental to the profit-producing transaction is a question of fact. In CIR v Datatronic Ltd [2009] 4 HKLRD 675, the taxpayer was a Hong Kong company. It had a 100% owned subsidiary called Datatronic (Shunde) Corporation (‘DSC’) established in the Mainland undertaking processing works for the taxpayer. A processing agreement was entered into between the taxpayer and DSC whereby the taxpayer agreed to provide raw material, training, supervision of labour, design, technical know-hows, product specifications and quality control standards, and training and supervision of local staff in the Mainland. A deputy general manager, production manager, production controller and engineer would station in DSC to monitor and manage its operation. The supply of finished goods by DSC to the taxpayer was in 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 setting off the raw material supplied by the taxpayer to DSC.

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24. In Datatronic, Tang VP (as he then was) emphasized the importance of not confusing technical or other assistance given to a seller by a buyer as a profit-making transaction. In allowing the Commissioner's appeal, Tang VP agreed with the submissions of counsel for the Commissioner at paragraphs 21 and 23 of the judgment that '*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 essentially to the operations and profitability of the buyer's business, are merely antecedent or incidental to the transactions which generated the profits*'. Tang VP illustrated this with reference to the following example at paragraph 26:

'... 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 HK\$2 and then resold at HK\$3, the profit of HK\$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.'

25. Tang VP, after reminding himself of the principles set out by Lord Millett NPJ and Ribeiro PJ in ING Baring, came to the conclusion at paragraph 35 that:

'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.'

26. On the question of whether DSC could be regarded as an agent for the taxpayer in carrying out manufacturing work in the Mainland, the Court of Appeal in paragraph 36 of the judgment confirmed the conclusion by the Board that the manufacturing activities carried on by DSC were not the activities of the taxpayer:

'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.'

Discussion and Analysis

Negotiation and Conclusion of a Supply Agreement

27. By the A's Written Submission, Ms Lo (of the Representatives) submitted that the Purchaser Order No XXXX issued by the Company B and dated 14 December 2016 was only a brief intention of the items they required. It did not form a conclusion as the items on the order might not fit the actual conditions that were available in the site. Ms Lo claimed that the bill issued to Company B for deposit was only regarded as an acceptance of invitation to have further site visit for details (sic) discussion of the items which could not be available to Company B that fitted their actual situation and conditions.

28. Ms Lo further submitted that despite the fact that Mr A confirmed that once the deposit was received from Company B, it only indicated that they were willing to have a second trip to further discussion with Company B not the conclusion of sales (sic). Her submission was made against the background that Mr A in his oral testimony accepted that there was a binding contract between the Appellant and its counterparty once the Purchase Order was signed and deposit was paid by Company B on or about 15 or 16 December 2016.

29. It is not disputed by Ms Lo that when Mr A was contacted by Company B in November 2016, Mr A flew to City C to meet its representatives to discuss the requirements of the end-user (which was a 6-star hotel in Country D). After his return, Mr A prepared a preliminary quotation in excel form to Company B ('Preliminary Quotation'). The parties then followed up the negotiation of the supply contract by way of telephone calls and by e-mails. In A's Written Submission, Ms Lo submitted that the phone calls and emails could not be treated as conclusion of items of sales. She alleged that Mr A had to bring along with him all physical items mentioned by Company B during the visit and presented and demonstrated them in front of Company B and their end user to confirm the quality and price range of items. We have to say that nothing alleged by Ms Lo in this regard is supported by any evidence. Neither was the Preliminary Quotation produced by the Appellant to the Respondent or the Board for consideration.

30. Consequently, the Company B sent the Appellant the Purchaser Order No XXXX dated 14 December 2016, which was signed by both Company B and the Appellant. This Purchase Order consisted of seven pages, which set out details of items, the number thereof, the unit price and the contract amount. The number of items stated in Purchase Order XXXX was about 150 to 200. The total amount stated in Purchase Order XXXX was HK\$7.0 million. Apart from the items ordered, the Purchase Order at the end set out the Terms of Payment: (a) 40% - deposit; (b) 50% - FOB City X and (c) 10% after installation.

31. In the oral submission held on 2 September 2021, Ms Lo submitted that

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although Mr A admitted that there was a contract upon receipt of deposit paid on 16 December 2016, it was actually an agreement to negotiate the terms of the supply contract further.

32. Mr A and Mr J, the sales manager flew again to City C between 17 and 24 February 2017. Ms Lo claimed that although in between the two trips taken in December 2016 and February 2017, there were telephone communications and e-mails correspondences, they were no more than reminding Mr A to fly to City C again and reminding him to bring along further information to confirm a sale and the specification of products. Ms Lo submitted that the telephone discussions or e-mail correspondences made by Mr A were scarce because all such contacts were conducted by Mr J and the staff of the sales department.

33. We note that the Appellant's file reference number 'XXX-XX-XXXXX' was printed on the Purchase Order. Apparently, there should be a file containing the relevant documents in relation to the documents supplied to the Company B (including the Preliminary Quotation) in the course of negotiation for the agreement. Regrettably, such documents as the emails exchanged between November 2016 up to February 2017 were not produced to the Board for its consideration. We do not accept Ms Lo's submissions made in paragraphs 27 to 32 hereof in the absence of those emails, the Preliminary Quotation and relevant documents produced to the Board for consideration and in the absence of evidence in this regard.

34. Ms Lo submitted that there was a contract made only after the set-up of a sample room on 22 February 2017 when the products and their specifications were known. Her submission appears to have contradicted Mr A's evidence that a sample room was set up in the April 2017. According to Mr A, the February 2017 trip only focused on site measurements and in-depth discussion on the end-user's need.

35. No matter whether a supply contract was made in February or April 2017 as claimed, Ms Lo said that the parties did not sign any paper relating to the supply agreement. It was made only by mutual understanding of the parties. Ms Lo submitted that after the Appellant provided a demonstration which was accepted by the customer, there would then be an oral agreement on the specifications and qualities. The Appellant would provide at site a floating unit price of 'plus and minus five percent' of the price to the end-user. In A's Written Submission, Ms Lo submitted that after demonstration and quoting a price range (of which + / - five percent (5%)) ('Floating Unit Price') by the Appellant and was agreed by Company B and end-user during the site visit, the items selected and price range will be used for producing the invoices to Company B.

36. When asked whether the Floating Unit Price was in writing, Ms Lo submitted that there was no document recording the Floating Unit Price. Ms Lo claimed that Mr A just gave a unit price to the end-user (which was quoted on the basis of the Appellant's costs and the profit) and told the counterparty that the final costs would be subject to 'plus and minus five percent (5%)', that was the Floating Unit Price.

37. We are surprised by her submission on Floating Unit Price because there was

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nothing in the evidence of the Appeal to support her allegations.

38. Setting aside the question that it was only a mere or bare allegation for a moment, it is difficult to understand what Ms Lo wanted to say. If the unit price of an item provided to the end-user was already the Appellant's cost plus the Appellant's deserved profit ('Sale Cost'), we do not understand how and why it was necessary for the Appellant to put a 'plus and minus 5 percent (5%) of the Sale Costs' thereon.

39. In order to elaborate further on the 'plus and minus five percent unit price (5%)' Ms Lo explained that Mr A verbally provided the unit price of each item at site to the end-user but the final price charged would be based on an adjustment of 'plus and minus five percent (5%)' on the unit price given by Mr A. She said this would be reflected in the invoices to be issued to the Company B. We have to say that this allegation was again without any evidence in support. This is a bare allegation made by Ms Lo. In the absence of any evidence explaining how it worked, we simply do not accept the submission that the cost of each item was agreed orally between the Appellant and the counterparty that the agreed price of an item was 'plus and minus five percent (5%) of the Sale Cost'.

40. Ms Lo submitted that the terms of the supply contract were best represented by the site reports. As to the other terms of the supply agreement such as the payment terms and completion date, she said that all such terms were verbally agreed between the Appellant and Company B or the end-user at the site. There was nothing reduced into writing. Even if we, for discussion purpose, assumed that all such other terms were verbally agreed, there was no evidence from the Appellant nor any submission from Ms Lo what the other terms were.

41. A cursory look on the so-called site reports will find that there were four columns on each page of the site reports. The titles of the first and second column are respectively 'Location' and 'Things to Do'. The third column contains some photos under the title 'Photo' while the fourth column's title is 'Remarks'.

42. The first three pages are marked with 'Site Report: 08 Nov 2016 – 14 Nov 2016'. The 4th page is marked with '16 Dec 2016 – 20 Dec 2016'. The 5th page is marked with 'Site Report: 17 Feb -24 Feb 2017'. The 6th to 9th pages are marked with 'Site Report: 04-10 April 2017'. The next three pages are marked with 'Site Report: 25 Apr – 01 May 2017'. The last page is marked with 'Jun – 13 June 2017'. There were some remarks and photos under the relevant columns.

43. Despite our diligence in reading the site reports, we cannot find that such site reports could represent any contract made between the Appellant and Company B or its end-user as claimed by Ms Lo, not to mention that there was nothing mentioned about the agreed terms.

44. Ms Lo argued that the terms of payment, the quality to be supplied and the delivery dates should be reflected in the invoices which were issued by the Appellant to the counterparty. When asked whether she could refer the Board to the invoices which were in the bundle, she told the Board that she had forgot to bring the invoices to the hearing. When

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she was reminded that in the course of objecting the assessment made by the Respondent, the Representatives should have supplied all relevant documents including the invoices she referred to with the Respondent, she did not answer the question directly but repeated that she could not produce the original invoices at the moment.

45. In a supply contract, there should be some important terms (other than the items to be supplied and the sale prices). In the Appellant's case, it should be so because the contract sum of the subject supply agreement amounted to HK\$7 to 9 million.

46. Company B was a Country Y company while the user was a 6-star hotel in City C. In a commercial world, it is difficult to imagine that the terms of payment of the contract (whether deposit or part payments), the delivery schedule of products, the completion date of the project, detailed items to be supplied, the quality of products to be supplied, the production method of blinds and other terms are not reduced into writing and all the important and major terms of a supply agreement were made by words of mouth. In a multi-national supply contract, the choice of law to interpret the agreement and the mode of resolving any disputes should be parts of the agreement. We do not think that in the case of dispute, each of the contracting parties would respectively rely on its memory of the oral terms (including each unit price of about 150 to 200 items ordered) and other agreed oral terms. We do not think that the contracting parties would not agree the choice of law to interpret the agreement or the place of forum to resolve their dispute beforehand. Ms Lo's submission was grounded on nil evidence basis. It flies in the face of common sense to accept the submission that the Appellant and the Company B the subject supply agreement was made by words of mouth.

47. By the letter of 9 December 2020 from the Representatives, Ms Lo delivered to the Respondent a list of sales invoices (not the invoices themselves) issued to Company B as per Appendix IV of the said letter.

48. Ms Lo submitted that a supply agreement was made on 22 February 2017 and the quantity of products, the payment method and quality of the products should be reflected in the invoices to be issued.

49. Contrary to her submission, if Ms Lo cared to read the list of invoices supplied by the Representatives (or by herself) to the Respondent on 9 December 2020, she should find that apart from the payment of the deposit of HK\$2.8 million (no matter it was paid on 15 or 16 December 2016), 2 further invoices were *inter alia* issued on 10 February 2017. If the supply agreement was only made on 22 February 2017 and the agreed terms could be represented by the invoices subsequently issued by the Appellant to Company B, we could not understand the basis upon which these two invoices (dated 10 February 2017) were issued by the Appellant to Company B for payment. These two invoices simply negate Ms Lo's submission that a binding supply agreement was only made between the parties on 22 February 2017 which was reflected in the invoices to be issued.

50. There was clear and unequivocal evidence that the Purchase Order No XXXX was accepted and signed between the Appellant and the Company B on or about 14 December 2016 and deposit of HK\$2.8 million had been received by the Appellant on or

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about 15 or 16 December 2016. Mr A, unmistakably, confirmed that there was a binding contract made between the Appellant and the Company B after the Appellant's receipt of deposit paid by Company B.

51. The written submission or the oral submission made by Ms Lo on behalf of the Appellant could not persuade us to accept that Mr A was mistaken and a supply agreement (with all essential terms) was made orally between the Appellant and Company B (or the end-user) at City C on 22 February 2017 as alleged. We reject Ms Lo's submission in this regard.

52. Based on Mr A's evidence and paragraph 2 of the grounds of appeal, we find that Mr A had a meeting at City C in November 2016 with the representative of Company B when they had a preliminary discussion on the contract. After Mr A returned from City C, Mr A and his sales department continued the negotiation with Company B by e-mail and on phone. When Mr A grasped an understanding on the scope of products to be ordered, Mr A sent by e-mail an excel file (being the Preliminary Quotation) to Company B. Based on the Preliminary Quotation provided by Mr A, Company B was able to provide the Purchase Order No XXXX to the Appellant which was accepted and signed by the Appellant on or about 14 December 2016. The acceptance was unequivocally expressed by Mr A's signature endorsed therein. We have no hesitation to draw the inference that a binding supply agreement was made between the Appellant and the Company B on or about 14 or 15 December 2016 ('Supply Agreement'). The Supply Agreement was further reinforced by the payment of deposit of HK\$2.8 million by Company B to the Appellant.

53. Although the negotiation of the Supply Agreement was first initiated by Mr A's site visit in City C in November 2016, no supply agreement was concluded then. The Supply Agreement represented by the Purchase Order No XXXX was made consequent upon further negotiations by phone and by e-mails exchanged between Mr A and/or his staff in Hong Kong and the Company B. The Board finds it a fact that the Supply Agreement was concluded and made in Hong Kong by the parties, the negotiation of which were conducted by e-mails and phone discussion in Hong Kong on the part of the Appellant. The payment of deposit was made to the Appellant's bank account in Hong Kong. The Supply Agreement was to supply certain items relating to blinds to the Company B.

54. The Appellant claimed that the subject contract was special and not simply a supply agreement because the Appellant had to attend site visits, site measurements and preparation for electricity wiring plans for motors (for integration into the Room Control Unit of the hotel). We agree with R's Written Submission that such activities were activities antecedent or incidental to the sale of the blinds under the Supply Agreement, which should not be regarded as the Appellant's profit-generating activities. The profit-generating activities undertaken by the Appellant was the acquisition of and the sale or supply of blinds to the Company B pursuant to the Supply Agreement.

Purchase of Parts for Production

55. Regarding the purchase of parts for production of rails for automatic blinds, Ms Lo claimed that the major parts were motors for the rails. She agreed that it was an

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important purchase for production of the products to be supplied. The motors for the railings for the Supply Agreement were supplied by Company U which was a foreign company with a branch in Hong Kong. According to Mr A, the motors were ordered by the Appellant's staff in Hong Kong because those in City E Office could not communicate in English with the supplier. Anyway, the motors would be delivered to the City E Office for production upon taking delivery from the supplier in Hong Kong. As to other parts, Mr A claimed they were acquired by City E Office in the Mainland. Ms Lo stressed that although invoice for the motors was issued to the Appellant by Company U, it could not prove that the purchase was made in Hong Kong.

56. We note that for the Supply Agreement, there was another invoice issued by a Hong Kong company called Company Z and dated 21 December 2016 (our emphasis) to the Appellant. When Ms Lo was asked if the purchase mentioned in this invoice was from Hong Kong, she submitted that though it was from Hong Kong, the purchase amount was relatively small (i.e. HK\$14,609).

57. In our view, although this invoice involved a small sum of HK\$14,609, it was an important document to support that a binding Supply Agreement was made between the Appellant and the Company B on 14 or 15 December 2016. The Appellant needed to acquire parts for production of the ordered items. In our view, the Appellant needed to purchase parts for production only after a binding supply agreement was made. This piece of evidence negates Ms Lo's submission that a binding agreement was only made on 22 February 2017.

58. In their letter of 9 December 2020, the Representatives submitted Appendix II (which contained the Costs of Material of City C's project) to the Respondent for their consideration. The total amount of purchases from six suppliers of parts for the Supply Agreement were HK\$1,680,644. Out of these six suppliers, there were only two suppliers in the Mainland. The total amount of purchases from these two suppliers were HK\$43,385.

59. The delivery costs incurred for transport of the parts from Hong Kong to City E Office amounted to HK\$53,204.

60. If we disregard the transportation expenses of HK\$53,204 for a moment, the amount incurred for purchases of parts from the suppliers in the Mainland were HK\$43,385 and the amount incurred for purchases of parts from Hong Kong or overseas suppliers were HK\$1,637,259. In terms of money, about 97.42 % ($\text{HK\$1,637,259} / (\text{HK\$43,385} + \text{HK\$1,637,259})$) of the amount was paid to Hong Kong and foreign suppliers. There was only about 2.58% of the total amount incurred for purchases of parts in the Mainland.

61. If we treat the transportation expenses of HK\$53,204 as amount paid for the purchases not from the Mainland, about 97.49% ($\text{HK\$1,690,463} / (\text{HK\$1,690,463} + \text{HK\$43,385})$) of the amount were paid to Hong Kong and foreign suppliers, while 2.51% of the total amount was incurred for purchases of parts in the Mainland.

62. From the above figures, we do not accept Ms Lo's submission that most of the purchases of the parts for the Supply Agreement were made in the Mainland by the City

E Office. Contrary to her submission, we find it a fact that in terms of money, more than 90% of the materials for production of the ordered items under the Supply Agreement were acquired in Hong Kong by the staff of the Appellant. Those parts were delivered to the City E Office for processing or manufacturing.

Manufacturing of Rails for Automatic Blinds

63. It was submitted in A's Written Submission that the Appellant had their own factory in City E, which worked as a branch of the Appellant. City E Office's manager was required to produce a monthly report to Hong Kong office with all detailed items of expenses. All expenses were records (sic) in the accounting records of the Appellant. According to 'substance over form' principal, it was the Appellant's submission that the City E Office was not a separate legal entity even though it did not have a legal basis (sic).

64. Ms Lo claimed that equipment for production of City E Office had been booked under furniture, fixtures and equipment of the Appellant's accounting records. She further submitted that the role of City E Office was to manufacture blinds and storage of stocks serving the Appellant as well as Mr A's company in Singapore and other related companies. The Appellant also recorded the relevant sales to those companies included in the financial statements of the Appellant under the related-parties' transactions.

65. In A's Written Submission, it was further submitted that administration rule of regulations of factory, like clock in and out system, were the same as those of the HK Office (sic). Thus, Mr L did clock in whenever he visited the factory during office hours. Mr L would provide the production instruction in the City E Office and supervise the progress during every weekly visit (sic). Ms Lo submitted that materials for assembly of blinds were delivered to City E Office. The City E Office arranged for sewing of blinds, assembly of the accessories and storage of the finished goods and stocks. The finished goods were collected by the Company B's representative from City E Office for sending to City C's site (sic).

66. Ms Lo said the Appellant had provided machinery to City E Office for production purpose. By reason thereof, she submitted that it supported her claim that the City E Office was an agent of the Appellant. She referred the Board to Schedule 4 of the Appellant's Profits Tax Return – Corporations (Final Assessment 2016/17 and Provisional Payment 2017/18). In the said schedule, two machines of total value of HK\$174,897 were recorded under City E Office. Having considered the said schedule, we do not feel that the mere fact that two items were recorded under 'City E Office' could show that the City E Office was an agent of the Appellant as alleged.

67. In reply to the Respondent's query, the Representatives sent Appendix 1 under cover of the Representative's letter of 9 December 2020 to the Respondent. Appendix 1 (entitled Staff Salary and Allowance) recorded (1) the Appellant's name of staff, (2) their Hong Kong Identity Card Numbers; (3) their position; and (4) their salary. It is noted that the words 'PRC' was put before the names of 14 staff (to indicate they were staff working in the City E Office). There was an item at the end marked with 'PRC' - operating costs for Jan-Feb 2017. This information was provided by the Representatives to the Respondent in

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response to their enquiry. The information was self-serving and lack of explanations. Ms Lo submitted, but we do not agree, that such entries could prove one way or the other that the City E Office was the Appellant's branch or agent.

68. According to Mr A, the City E Office was set up by one of the Appellant's staff for the Appellant. His staff was the proprietor of the City E Office holding a license to do business issued by the relevant authority in the Mainland. Apart from the mere claim of Mr A, we do not find there was any one piece of evidence from the Appellant showing any nexus between the Appellant and the City E Office or the Appellant and the license holder. In short, there was no evidence establishing any principal and agent relationship adduced by the Appellant.

69. In any event, Mr A confirmed in his oral testimony and Ms Lo conceded that the Appellant did not have a business license issued by the Mainland authority at the material time to conduct business in the Mainland.

70. We agreed with the principle endorsed in Datatronic that whenever 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 Appellant's case, the Appellant did not have a license to carry out the production work in the Mainland, thus it could not possibly empower the City E Office (or his licensed staff holding the City E Office) as its agent to carry out the production work on its behalf. Although it is lawful for the City E Office (or his licensed staff holding the City E Office) to carry out the production of railings for automatic blinds, it manufactured the same in its own capacity. By reason of the aforesaid, we accepted R's Written Submission that the City E Office (or his licensed staff holding the City E Office) could not possibly be the Appellant's agent. There did not exist any agency relationship between the Appellant and the City E Office as claimed by the Appellant.

71. Following the authorities of ING Baring, Datatronic and CG Lighting, the manufacturing activities of the City E Office, being non-agent third parties, should not be regarded as the manufacturing activities of the Appellant.

72. The Appellant stressed that the provision of the equipment for production to the City E Office by the Appellant and the provision of production instruction and the supervision of the production progress by Mr L of the Appellant on weekly basis could support the fact that the City E Office was the Appellant's agent. We do not agree. Applying the authorities of ING Baring, Datatronic and CG Lighting, we agreed with R's Written Submission that such activities were merely the Appellant's activities antecedent or incidental to the profit-generating activities. Such activities should not be regarded as the Appellant's own profit-generating activities.

73. By reason of the aforesaid, we do not think that the Appellant had engaged in any manufacturing activity whether in Hong Kong or the Mainland. One of the activities that produced profits to the Appellant was its acquisition of blinds manufactured by the City E Office for trading purposes. We do not have doubt that the provision of parts to the City E Office and the involvement of Mr L to give instructions to the staff of the City E Office

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for production purposes were antecedent or incidental activities which should not be regarded as the Appellant's own profit-generating activities.

74. In a normal case, the information provided to the custom clearance authority for cross-border transport of the blinds from City E Office to the Appellant or its end-user could give some light on the manner in which the City E Office supplied the manufactured products to the Appellant or their end-users. The information should give some hints as to whether the blinds were manufactured by the City E Office as principal or as agent for the Appellant or whether the blinds were delivered to the Appellant or their end-user by way of sale and purchase or otherwise. However, Mr A said that he only needed to provide the packing lists to the logistic company which would follow up the whole cross-border transport matter for the Appellant. He did not know what sort of documents were provided by the logistic company to the custom clearance authorities or what information the Appellant provided to them. This answer obviously would not assist the Appellant's submission that the City E Office was its agent to manufacture the blinds.

75. The fact that the Appellant was not engaged in any manufacturing activity is reinforced by the contents of its audited reports and financial statements for the years ended 31 March 2017 and 31 March 2018 which were audited by the Representatives. Both reports confirmed that the principal activity of the Appellant was general trading. Nothing in the reports described that the Appellant was engaged in manufacturing activities.

76. Based on the evidence before us, we can only conclude that the City E Office was an entity separate from the Appellant and the Appellant acquired the blinds from the City E Office for the purpose of supplying them to the Company B.

Installation of Blinds

77. In A's Written Submission, the Appellant submitted that the installation of blinds was a key essential business activity in considering the source of the Subject Profits. Ms Lo argued that although the installation works was performed after April 2017, the antecedent activities had been done for ensuring that the installation works condition was available. The antecedent activities including site measurement, review the condition of site, electrical wiring condition, structure restriction, side track recess slot measurement had been done as shown on the site report during 16 December 2016 to 20 December 2016 as well as 4 April to 10 April 2017 provided by the Appellant. Ms Lo submitted that without the antecedent activities, installation works cannot be completed. She stressed that installation supervision by the Appellant's staff and conclusion of the completion of installation were all performed in site in City C, i.e. outside Hong Kong.

78. In her oral submission, Ms Lo said that the installation charges were only about ten percent (10%) of the total amount charged to customer only because the Appellant put part of the installation charges (being the antecedent works) into the costs of the final products. She stressed that apart from installation, the supply contract also included the site management. Ms Lo argued that although the installation of the blinds was done after April 2017 (outside the financial year in which the profits were in dispute), the antecedent works such as verification of site, site measurement etc. were done in the subject financial year

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(prior to April 2017). We have to say that there was no evidence whatsoever to support the allegation that part of the installation costs was embedded into the unit price. This was only a bare allegation from Ms Lo.

79. Even if we put aside the issue of lack of evidence for a moment, we feel the above submissions are inconsistent to each other. If the costs of the antecedent works had been embedded into the unit price of the items supplied, that means the antecedent works should have no further relationship with the installation charges (being ten percent (10%) of the contract sum). It therefore remained the fact that in money term, the installation work amounted to ten percent (10%) of the contract sum of the Supply Agreement.

80. We should not ignore the fact that neither the Appellant nor its staff had permits to perform installation work in City C. This was confirmed by Mr A. As such, the Appellant had to rely on local workers or some contractors which had the permit to do the installation work in City C. According to Mr A, the Appellant only sent two to three experienced technicians to give training or instructions to the local contractors on site.

81. Having considered the amount of installation charges and the work in relation to installation undertaken by the Appellant itself, we feel the provision of guidance of installation of blinds and training to the local worker at site by two to three experienced technicians of the Appellant were antecedent or incidental activities which should not be regarded as the Appellant's own profit-generating activities.

Finding of Facts

82. It is not in dispute that the Appellant was a Hong Kong company and conducted business in Hong Kong in the relevant financial years. The Appellant claimed that the key essential business activities in relation to the supply and installation of blinds in City C were carried outside Hong Kong. Accordingly, the Appellant argued that the Subject Profits were offshore profits and not subject to Hong Kong Profits Tax.

83. Based on the analysis and discussion set out above, we find that the negotiation and conclusion of the Supply Agreement with the Company B was made between the Appellant and the Company B in Hong Kong.

84. Parts for essential components for the ordered items under the Supply Agreement were supplied by Hong Kong companies or overseas suppliers. The Appellant placed orders for the parts by its staff in Hong Kong and paid the purchase prices thereof. The goods were first sent to Hong Kong which were then transported to the City E Office for processing. Less than ten percent (10%) of the parts were acquired by City E Office. The Appellant sent the purchased parts to the City E Office and instructed and ordered the City E Office to manufacture the ordered items. The finished products were later supplied by the City E Office as a principal to the Appellant. The City E Office was not an agent of the Appellant as far as manufacture of the ordered items were concerned.

85. The manufactured items were acquired in Hong Kong by the Appellant from the City E Office for the purpose of selling to the Company B. The profit-generating activity

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undertaken by the Appellant were the acquisition and the sale of blinds and accessories to the Company B (or the end-user) under the Supply Agreement. The other activities undertaken by the Appellant were activities incidental to the acquisition and the sale or supply of blinds or accessories.

86. All invoices were issued and sent from the Appellant to the Company B in Hong Kong. All payments were made by Company B to the Appellant by way of transfers into the Appellant's bank accounts in Hong Kong.

87. The blinds were installed at site. The installation charges under the Supply Agreement were about ten percent (10%) of the total contract sum of the Supply Agreement. The installation activities undertaken by the Appellant were antecedent or incidental activities of the sale of blinds which should be disregarded in considering the source of the Subject Profits.

88. Applying the 'totality of facts' principle, having considered all the circumstances and all the Appellant's activities which generated the Subject Profits and the evidences, it is our conclusion that the Appellant's operations were to acquire blinds and the associated items or automatic railings from the City E Office and to supply or sell them to Company B pursuant to the Supply Agreement. Both the acquisition and sale and purchase of blinds and accessories were done in Hong Kong which generated the Subject Profits. The installation of the blinds and railings at City C was incidental to the said sale and purchase. The claim that the Subject Profits was generated offshore is rejected. We have the firm view that the Subject Profits arose in or were derived from Hong Kong.

Disposition

89. Given our finding of facts, it is the Board's decision that the Appellant has failed to discharge, under section 68(4) of the IRO, its onus of proving that the assessment appealed against is excessive or incorrect.

90. Accordingly, the appeal is dismissed and the Revised Profits Tax Assessment is hereby confirmed.

Costs

91. Under section 68(9) and Part 1 of Schedule 5 of the IRO, if the Appellant fails in its appeal, the Board may order the Appellant to pay as costs of the Board a sum not exceeding the amount of HK\$25,000.

92. As discussed and analyzed in the above, the evidences called by the Appellant to support its claim that the Subject Profits earned in the assessment year of 2016/17 were offshore were flimsy, vague and contradictory. As an example, it is hard for any reasonable man to believe that in an international trade (not to mention that the end-user was a 6-star hotel), there was no written contract made between the Company B and the Appellant. Likewise, it is difficult to imagine that there were no written correspondences or scarcity of correspondences exchanged between the parties before a purchase order of 7

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pages (with 150 to 200 items) could be concluded. Likewise, in administering the contract, there should be variation orders and substantial e-mails or correspondences should be exchanged. However, for unknown reason, the Appellant saw fit to keep those correspondences confidential from the Respondent or the Board.

93. Many submissions made by the Appellant were bare allegations without support of evidences. Further, the documentary evidences in the hearing bundle contradict with some of the submissions made by the Appellant.

94. The Appellant chose not to comply with the directions given by the Board in relation to filing and service of witness statement(s). Had the Appellant complied with the directions, it could have helped save a lot of the Board's time.

95. The Subject Profits was HK\$1,257,944 and the tax benefit involved was quite substantial. It follows that there is every temptation for the Appellant to take this Appeal even though its case is weak or hopeless. In the Board's view, there is no reasonable prospect of success in the appeal. It suggested that the Appellant knew very well that there were no good grounds to appeal. This is just a frivolous and vexatious exercise on the part of the Appellant.

96. Substantial amount of public fund is incurred to deal with the Appeal. We do not see any reason why the general public has to bear the costs of the Board in dealing with this unmeritorious and unarguable appeal.

97. In the circumstances, the Board feels it right to order and herein orders the Appellant to pay a sum of HK\$25,000 as costs of the Board which shall be added to the tax charged and recovered therewith pursuant to section 68(9) of the IRO.