

Case No. D25/22

Profits tax – appellant being trading arm of the group – appellant allegedly having no employees, profit generating activities, stocks or bank account in Hong Kong – whether appellant carrying on trade or business in Hong Kong – whether business arising in or deriving from Hong Kong – sections 14(1), 68(4) and 68(9) of the Inland Revenue Ordinance (Chapter 112) (**‘IRO’**)

Panel: Maurice Joseph Chan (chairman), Robin Gregory D’souza and Hui Lap Tak.

Dates of hearing: 1-3 June 2020.

Date of decision: 3 January 2023.

The appellant (**‘Company A’**) was incorporated in Hong Kong engaging in the leasing of shipping containers (a business previously operated by another company (**‘Company N’**)). The ultimate and immediate holding companies of Company A were respectively Companies K and L. The group of companies in which Company A belonged (**‘Group’**) undertook a reorganization, after which Company A became the trading arm of the Group. Although Company A maintained a registered office in Hong Kong, it was actually the office of its company secretary. According to its representative, Company A did not employ any employees, nor carry out any profit generating activities (apart from trading of shipping containers, which was undertaken outside Hong Kong), nor maintain any stock of shipping containers or bank account in Hong Kong.

Regarding the leasing of shipping containers, it was said that after purchasing the shipping containers, they would first be leased by Company A to another company (**‘Company S’**), which then sub-leased to lessees outside Hong Kong. Substantial part of the leasing income generated by sub-leasing of shipping containers would be distributed by Company S to Company A. In this regard, a lease agreement was entered into between Company A and Company S (**‘Lease Agreement’**), under which Clause 1(b)(iii) expressly provided that:

‘the Lessor and the Lessee agree (A) to treat the transactions contemplated by this Agreement as a true lease of the Lessor Containers by the Lessor to the Lessee for Hong Kong Profits Tax purposes, and Country T income tax purpose, and (B) to cooperate and take positions consistent with such treatment in filing their respective Hong Kong Profits Tax and Country T Income Tax returns, if any.’

The Group chose to establish Company A in Hong Kong because: (a) suppliers in the Mainland and customers in Asia preferred carrying on business with an entity in Hong Kong; (b) incorporation in Hong Kong increased the credibility of Company A to its customers and suppliers; (c) it was easier to set up a company in Hong Kong than in the

Mainland; and (d) due to foreign exchange control in the Mainland, setting up Company A in Hong Kong would give greater flexibility for Company A to do business.

Pursuant to the profits tax return lodged by Company A, the Assessor took the view that Company A's trading profits, leasing profits, commission income and disposal gains were all profits arising in or derived from Hong Kong and should be chargeable to Profits Tax. Company A objected to the Assessor's assessment. Pursuant to a determination of 14 October 2019 (**'Determination'**), the Commissioner dismissed Company A's objections and took the view that Company A had carried on a business in Hong Kong for the following reasons: (a) Company A was set up in Hong Kong as the trading arm of the Group's business in Asia; (b) Company A's business involved the buying of shipping containers from unrelated suppliers and selling of pooled shipping containers to customers. To make them tradeable, the shipping containers were first leased to its related company, Company S, for sub-lease to third parties; (c) invoices for management fees from Group companies were also issued to the Hong Kong address of Company A; (d) the relevant commission income was trading profits sourced in Hong Kong; (e) the leasing profits were sourced from Hong Kong; (f) disposal gains should also be regarded as sourced in Hong Kong.

Company A appealed to the Board, seeking, *inter alia*, an order for the Determination to be set aside. There were two issues before the Board, namely: (1) whether Company A carried on a trade or business in Hong Kong (**'Locality Issue'**); and (2) whether business carried on in Hong Kong arose in or was derived from Hong Kong (**'Source Issue'**).

Held:

General principle

1. Section 14(1) of IRO could be broken down into 3 limbs cumulatively, which must all be satisfied for a charge to profits tax to arise: (a) a person must carry on a trade, profession or business in Hong Kong; (b) the person must derive Hong Kong sourced profits (that is, profits arising in or derived from Hong Kong); (c) those Hong Kong sourced profits must be the profits of the specific trade or business carried on in Hong Kong.

Locality Issue

2. In the case of a body corporate, any gainful use to which it put its property might in principle amount to the carrying on of a business. The threshold of being found to carry on a business in Hong Kong was low, and usually called for some activity on the part of whoever carried it on. In a statutory context (analogous to that of IRO), carrying on a business implied a repetition or series of acts in the pursuit of commercial gain (American Leaf Blending Co. Sdn. BHD. v DGIR [1979] AC 676 and DEF v CIT [1961] MLJ 55 considered).

3. To identify where Company A carried on its trade or business, one must ascertain the locality where it conducted operations that put its assets to gainful or profit-making use. In the case of Company A, there was no dormancy in the sense suggested above. Although the documentary evidence of activities in Hong Kong might be very minimal, some repeated activities in the pursuit of commercial gain had been carried on. Considering the common ground that only a low threshold was required to satisfy the issue, the Board had no doubt that Company A did carry on a business in Hong Kong. This holding need not be based on what Company A was, or what pre incorporation aspirations the Group had for Company A to be incorporated in Hong Kong, or what it had wrongly declared to have done in Hong Kong, but what was in fact done on its behalf by its agents, wherever they might be.

Source Issue

4. The question of profits source was a hard, practical matter of fact to be understood not as a legal concept, but something which a practical man would regard as the real source of income. The broad guiding principle was that one should find what a taxpayer had done to earn the profit in question and where it had done it, discounting antecedent or incidental matters. The focus should be on the profit-producing transactions or operations themselves. One had to identify the proximate and actual cause of the profits. There were two limitations: (i) the operations must be those of the taxpayer; and (ii) the operations did not comprise the whole of the taxpayer's operations but only those which produce the profit in question (Rhodesia Metals Ltd (Liquidator) v CoT [1940] AC 774, CIR v Hang Seng Bank Limited [1991] 1 AC 306, Kwong Mile Services Ltd v CIR [2004] HKCU 782, CIR v HK-TVB International Ltd [1992] 2 AC 397, CIR v Orion Caribbean Ltd [1997] 1 HKLRD 924 and ING Baring Securities (Hong Kong) Ltd v CIR (2007) 10 HKCFAR 417 considered).
5. For the purpose of the appeal, the source of profits in Hong Kong could be distilled down to the following 3 key principles: (a) the inquiry must turn on the nature of the operations or transactions which gave rise to the profits; (b) the focus of the inquiry should be on the cause of the profits without being distracted by antecedent or incidental matters or activities amounting to technical assistance. And though such incidental or antecedent matters might, or would often be, commercially essential to the operation and profitability of the business, they were not relevant in ascertaining the source of the profits; (c) only the profit producing activities of the taxpayer should be taken into account, but not the activities of its affiliated companies. There was nothing to suggest that a profit could originate in Hong Kong in the absence of something done by the taxpayer by way of operation, activity, or transaction in Hong Kong (ING Baring Securities (Hong Kong) Ltd v CIR (2007) 10 HKCFAR 417, CIR v Datatronic Ltd

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[2009] 4 HKLRD 675, Kwong Mile Services Ltd v CIR [2004] HKCU 782, CIR v Hang Seng Bank Limited [1991] 1 AC 306, CIR v HK-TVB International Ltd [1992] 2 AC 397 and FCT v United Aircraft Corporation (1943) 68 CLR 525 considered).

6. For an asset trade, one had to look to where the contracts for the sale and purchase of the assets traded were effected. In that context, the term ‘effected’ had a broader meaning than merely ‘executed’. It included multiple stages of contract formation, such as negotiation, conclusion, and performance, and should not be construed mechanistically, but with reference to the specific facts of each case. This concept of effectuation presupposed some positive act of the taxpayer or its agents taking place in Hong Kong for the contracts to be said to be effected in Hong Kong (CIR v Hang Seng Bank Limited [1991] 1 AC 306, CIR v Magna Industrial Ltd [1997] HKLRD 173 and D14/15 (2016-17) IRBRD, vol 31, 44 considered).
7. Company A’s allegation that it had done nothing in Hong Kong to earn its profits, which were all effectuated by intra corporate agents in foreign countries, was incredible, given the inference to be drawn from its history of staff employment, operational office address and leasing activity. In particular, the declaration by Company A under the Lease Agreement was fatal, for it compellingly implied that Company A had historically treated and committed the profits from its leasing activities as chargeable to profits tax.

Appeal dismissed and costs order in the amount of \$20,000 imposed.

Cases referred to:

Commissioner of Inland Revenue v Orion Caribbean Ltd [1997] 1 HKLRD 924
Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306
Commissioner of Inland Revenue v HK-TVB International Ltd [1992] 2 AC 397
Kwong Mile Services Ltd v Commissioner of Inland Revenue [2004] 7 HKCFAR 275
Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Ltd [1992] 3 HKTC 703
ING Baring Securities (Hong Kong) Ltd v Commissioner of Inland Revenue [2007] 10 HKCFAR 417
American Leaf Blending Co. Sdn. BHD. v DGIR [1979] AC 676
DEF v CIT [1961] MLJ 55
Rhodesia Metals Ltd (Liquidator) v CoT [1940] AC 774
Commissioner of Inland Revenue v Datatronic Ltd [2009] 4 HKLRD 675
FCT v United Aircraft Corporation (1943) 68 CLR 525
Commissioner of Inland Revenue v Magna Industrial Ltd [1997] HKLRD 173
D14/15, (2016-17) IRBRD, vol 31, 44

Stefano Mariani, instructed by Messrs. Deacons, for the Appellant.

Ernest Ng, Counsel, instructed by the Department of Justice, for the Commissioner of Inland Revenue.

Decision:

1. Before the Board of Review is an appeal brought by **Company A**, formerly also known as **Company B** against the **Determination** made by the **Commissioner** (Deputy Commissioner of Inland Revenue) dated 14 October 2019, dismissing Company A's objections to the assessments and additional assessments to profits tax for the 6 years of assessment between 2008/9 to 2013/14. Company A seeks an order of the Board to set aside the Determination and to annul the Confirmed Assessments in full.

Background of the Group C ('the Group')

2.1 Generally, the factual background to this appeal is as set out in the agreed statement of facts contained in the Determination. These facts, though in considerable detail, are all important for deliberation in this appeal, because the Board's decision will inevitably depend on an analysis of the legal significance of these facts. It therefore pays to recite or paraphrase most of them in detail here, at the risk of apparent superfluity.

2.2 The corporate structures of the Group C, are succinctly summarized under this head as follows. In 2008, Company A was incorporated in Hong Kong. In its reports of directors, Company A described its principal activities as sale and leasing of shipping containers. In the notes to its financial statements, it declared an **Address D** as its registered office and principal place of business.

2.3 At the relevant times, its directors were:

- (1) **Mr E**;
- (2) **Mr F**;
- (3) **Mr G**;
- (4) **Mr H**, who resigned on 20 Dec 2010;
- (5) **Mr J**, who was appointed on 8 Feb 2011;

2.4 Company A regarded **Company K** and **Company L** as its ultimate holding company and immediate holding company respectively. Both were incorporated in Country M. Company K was a limited partnership, and its managing partners were Mr E, and Mr F.

2.5 Other members of the **Group** were, *inter alios*:

- (1) **Company N**, which was incorporated in City P, Country Q. It was involved in the trading, leasing and financing of shipping containers. In 2001, Company N had registered in Hong Kong as a non-Hong

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Kong company, its own branch which we shall refer to here as the **Company N HK Branch**, who, at one time, maintained an office at Address R. It was said to be engaged in the provision of liaison and administrative services. Mr G and Mr H were also directors of the Company N HK Branch.

- (2) **Company S**, which was incorporated as a limited liability company in Country T in 2007. Mr J was a director of Company S;
- (3) **Company U**, which was incorporated in City P;
- (4) **Company V**, which was incorporated as a limited liability company in Country T in 2012.

2.6 At all relevant times, Mr E and Mr F were the common directors of all of the above companies of the Group, which were all under the control of Company K and Company L.

2.7 In response to the Assessor's enquiries concerning the background of the Group and the establishment of Company A, its representative, **KPMG** replied, *inter alia*, that:

- (1) The Group was engaged in the business of operational leasing of shipping containers. The Group's shipping container leasing business was previously operated by Company N. The Group undertook a reorganization of its shipping container leasing business by establishing Company S in Country T in 2007 and Company A in Hong Kong in 2008.
- (2) After the reorganization, Company A became the trading arm of the Group and Company S became its leasing arm. Company N transferred its entire trading business in Asia to Company A, and most of its leasing business in Asia to Company S. Company N continued to handle the leasing business and sale of shipping containers of the Group in the Country Q, Country W and Country X.
- (3) Company A leased the shipping containers to Company S, which then subleased to lessees. Company S also acted as the manager for the leased shipping containers, responsible for managing the lease, repair and maintenance of shipping containers on behalf of Company A.
- (4) The Group chose to establish Company A in Hong Kong because: (a) suppliers in the Mainland and the customers in Asia, such as Country Y and Country X, preferred carrying on business with an entity in Hong Kong, where they were geographically closer with, rather than a Country Q entity; (b) the incorporation of Company A in Hong Kong increased the credibility of Company A to its customers and suppliers,

as Hong Kong had a robust legal system, and an independent judiciary that provided a fair and just operating environment for businesses, in addition to highly cost-effective arbitration services; (c) it was easier to set up a company in Hong Kong than in the Mainland; and (d) in addition, due to foreign exchange control in the Mainland, setting up Company A in Hong Kong would give it greater flexibility in doing business.

Alleged Modus Operandi of Company A and the Group

3.1 Regarding Company A's operations, KPMG gave an account as follows:

- (1) Company A maintained a registered office at the aforementioned HK Address, which was actually an office of its company secretary, **Company Z**;
- (2) It did not employ any employees or engage any agents in Hong Kong to act for or on its behalf in any capacity;
- (3) It did not have any other establishment outside Hong Kong, nor had it obtained any foreign business/tax registration certificate;
- (4) Its trading of shipping containers was undertaken by Mr G and Mr H outside Hong Kong. They did not carry out any profit generating activities for Company A in Hong Kong;
- (5) Company L provided administrative, human resources, IT, treasury, accounting, financial, technical and marketing services to Company A outside Hong Kong. In return, Company A paid Company L management fees according to a **Services Agreement** dated 3 April 2009 made amongst Company A, Company L, Company N and Company S. It took retrospective effect from 1 Jan 2009, and was signed by Mr E on behalf of all the parties. Company L charged Company A for provision of services on cost with an 8% mark-up. Invoices for the management fees were issued by Company L to Company A's HK Address;
- (6) Company A maintained a bank account with **Bank AA** in Country M. The Mr E and Mr F were the authorized signatories. Company A did not have any bank accounts in Hong Kong;
- (7) It had not paid any tax outside Hong Kong;
- (8) Its mode of operations for the relevant years of assessment was substantially the same.

3.2 KPMG further made the following contentions concerning the purchase of

shipping containers:

- (1) All shipping containers were purchased by Company A for trading purpose and not for leasing. The initiation, negotiation and conclusion of Company A's purchase contracts with third party suppliers were carried out by Mr H in Country T/Country M by emails, telephone and by visits to the suppliers' locations. He was assisted by the staff of the Group's Container Division, **Mr AB**, Position AC, and **Mr AD**, Position AS. Mr H had the ultimate authority to accept purchase orders for and on behalf of Company A. He retired in 2010 and was replaced by Mr J;
- (2) Formal purchase contracts were entered into between Company A and the suppliers for each purchase order;
- (3) Company A did not maintain any stock of shipping containers in Hong Kong;
- (4) During the relevant period, 2 container suppliers, referred to herein as **Company AE** and **Company AF**, were among the major suppliers of shipping containers to Company A.

3.3
account:

Regarding the sales of shipping containers, KPMG put forth the following

- (1) Company A carried out its sales transactions under three different situations: (a) under normal circumstances; (b) when financing was required; and (c) upon resale of owned shipping containers after end of their useful life; such containers were referred to as 'investment shipping containers', which we shall more conveniently abbreviate here as **ISCs**;
- (2) Under normal circumstances, the leased shipping containers were accumulated over a period of time until they were able to form a pool of shipping containers of similar character (such as age and size) for sale to customers, who were mainly financial investors investing in shipping containers;
- (3) The initiation, negotiation and conclusion of Company A's sales contracts with these investors/buyers were carried out by Mr G in the Country Q, by emails, by telephone and by visits to the customers' locations. Mr G had the ultimate authority to accept sales orders from the customers for and on behalf of Company A;

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- (4) Mr G was the Position AG of the Group. He rendered services on a daily basis, and was in charge of the relationship with the customers of the Group;
- (5) Company A's customers were recurring third party investors in the container industry;
- (6) No formal sales contracts were prepared in relation to the sales of Company A's shipping containers. The staff of Company L in Country M prepared invoices for Company A together with certificates of ownership of the shipping containers. The customers settled their accounts via wire transfer;
- (7) When financing was required, Company A would sell shipping containers to the Group's financing companies. Before 2012, Company A sold the shipping containers to Company U at cost, who would lease them to Company S for sub-leasing. The rent paid by Company S was recognized in the books of Company U. When Company A reached agreements with customers to sell the shipping containers, Company A purchased the shipping containers back from Company U at cost for onward sale. From 2012 onwards, Company V replaced Company U to provide financing to Company A;
- (8) For shipping containers which remained unsold after the end of their useful life, Company A sold them to Company S for disposal to some designated buyers outside Hong Kong. According to the Lease Agreement, Company S acted as Company A's agent to remarket and sell the shipping containers upon the termination of the lease. Company A paid Company S a commission fee equal to 5.5% of the net sale proceeds;
- (9) Amongst Company A's container customers, **Company AH** was its major customer during the relevant period.

3.4
as follows:

Regarding the leasing of the shipping containers, KPMG gave an account

- (1) Shipping containers would not be tradeable if they were not being leased. After purchasing the shipping containers, Company A first leased them to Company S, which then sub-leased to lessees outside Hong Kong;
- (2) Company A entered into a **Lease Agreement** (the Marine Shipping Container Variable Lease) with Company S dated 1 July 2009 with

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retrospective effect from 1 Nov 2008. The Lease Agreement was negotiated and executed by Mr G on behalf of Company A in the Country Q, and by Mr H on behalf of Company S in Country T;

- (3) Company S managed the shipping containers owned by Company A under the Lease Agreement. Company A did not intervene in the leasing business of Company S. Company S generated leasing income by sub-leasing the shipping containers. Company S distributed to Company A 94.5% of the leasing income net of operating expenses incurred, and retained 5.5% in its accounts as commission;
- (4) Company A only derived leasing income from Company S.

3.5 Regarding Company A's commission income from Company AH, KPMG put forth the following account:

- (1) To maintain a long-term business relationship with Company AH, Company A had been charging very competitive prices for its sales. The average gross profit margin of sales to Company AH was lower than that of sales to other customers;
- (2) In 2011, Company A renegotiated with Company AH, which accepted an adjustment made to Company A's profit margins in the form of commission for the years of assessment from 2008/09 to 2013/14. The following documents were provided to the Commissioner to support the claim:
 - (a) a **Container Advisory Agreement** dated 13 July 2011 entered into between Company A as advisor, and Company AH as investor; and
 - (b) **3 Invoices** issued by Company A at the HK Address to Company AH;

3.6 Regarding the storage and delivery of shipping containers, KPMG gave an account as follows:

- (1) After Company A purchased shipping containers from the suppliers, they would be stored at the suppliers' factories, until being sub-leased to lessees by Company S;
- (2) When the shipping containers were sub-leased, Company S sent booking confirmations to the lessees and the suppliers' factories or the sub-contracted depots to arrange for pickup of the shipping containers.

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The lessees picked up the shipping containers from the factories or the sub-contracted depots with the booking confirmations provided by Company S;

- (3) If the shipping containers were not leased when sold, they remained at the suppliers' factories or storage facilities. If the shipping containers were leased when sold, the shipping containers remained in the possession of the lessees until the end of the leasing period. The sales would only result in changes of legal titles of the shipping containers and no physical delivery would be required;
- (4) After the relevant leases expired, the shipping containers would be shipped and returned to Company S at sub-contracted depots for inspection and repair before they were leased again. Company S contacted sub-contracted depots by emails. The subcontracting fees were recorded in Company S's audited accounts as storage and repair expenses;
- (5) Company A did not have any depots in Hong Kong or overseas. But Company N and Company S had sub-contracted with 3 depots in Hong Kong during the years of assessment between 2008/09 to 2013/14:

3.7 Regarding the operations of Company N HK Branch, KPMG gave an account as follows:

- (1) Company N HK Branch was established in 2001 to provide liaison and administrative services to Company N in return for a service fee income. It did not involve in initiation, negotiation and conclusion of shipping container leasing contracts on behalf of Company N or Company A;
- (2) After the transfer of business of Company N to Company S and Company A in 2007, Company N-HK Branch ceased to provide services to Company N, and started to provide similar liaison and administrative services to Company S in handling its leasing business in Asia;
- (3) Staff members of Company N HK Branch were:
 - (a) **Ms AJ**, who was the Group's North East Asia Operations Supervisor. Her duties included providing depot management services; and obtaining booking confirmations and arranging with lessees for pick-up of shipping containers.

- (b) **Ms AK**, who was the Group's North East Asia Area Commercial and Marketing Director. Her duties included conducting market studies, strengthening relationships with existing customers and develop new customers' base, monitoring stocks of shipping containers under leased and pending resale, and monitoring invoicing process and account receivables.
- (c) **Mr AL**, who was the Group's Director of International Operations, was responsible for technical aspects of the shipping containers. His duties included maintaining good relationships with suppliers, managing inventory levels and records, designing and implementing procedures for repair standards and warranties, and leading and managing project and staff.

Employer's Returns for Ms AJ, Ms AK and Mr AL

4. For the assessment year of 1 Apr 2013 to 31 Mar 2014, an unusual turn of events took place which warrants careful scrutiny by the Board. On 9 May 2014, Company A filed an **Employer's Returns** of Remuneration and Pensions for Ms AJ, Ms AK and Mr AL, notwithstanding that they were supposed to be staff of Company N HK Branch. By a letter dated 1 May 2016, Company A informed the Assessor that it in fact had no employees working for its business for the year of assessment 2013/14, but that the Group's Human Resources Department in Country M had wrongly treated Ms AJ, Ms AK and Mr AL as its employees, because they had inadvertently overlooked the existence of Company N HK Branch. Further, Mr AL's pay slips were also found to be wrongly issued in Company A's name up to July 2014.

KPMG's Contentions

5.1 In support of Company A's offshore claim, it had provided the Assessor with a number of documents showing some representative trading transactions for the assessment years of 2008/09 and 2013/14. These documents, which have been listed and particularized in paragraphs 16 and 17 of the Determination, relate to:

- (1) A sample **Transaction 1** for 2008/09, which involved a supplier known as **Company AM** and Company AH as purchaser. In this connection, there was an agreement which we will refer to here as **APA** (Asset Purchase Agreement) entered into between Company A of the HK Address as buyer and Company AM as seller, for the purchase of some shipping containers for some USD22.26m. The APA, which Mr H signed on behalf of Company A, stipulated that any notices made to Company A had to be served to the HK Address.
- (2) A sample **Transaction 2** for 2013/14, which involved Company AF, Company AE, and **Company AN** as suppliers, and Company AH as

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buyer.

5.2 Regarding Transaction 1, KPMG contended on Company A's behalf, that:

- (1) Mr AB identified the purchase opportunity to acquire shipping containers from Company AM during a business trip to Asia (outside Hong Kong). The Company A's board of directors authorized Mr AB and Mr AD to negotiate with Company AM;
- (2) He and Mr AD undertook a due diligence on the shipping containers and issued Letter of Intent to Company AM. They, with the assistance from the Company A's legal representatives in Country W, negotiated the terms of the APA with Company AM, and that the APA was signed by Mr H in Country W;
- (3) Mr G initiated and negotiated the terms for the sale of shipping containers with Company AH by emails and telephone discussions from the Country Q and by meetings in Country AT;
- (4) Staff of Company L in Country M issued sales invoice together with copy of certificate of ownership to Company AH. Company AM arranged delivery of the shipping containers directly with Company AH outside Hong Kong;
- (5) Staff of Company L in Country M made payment to Company AM and received payment from Company AH on behalf of the Company A.

5.3 Regarding Transaction 2, KPMG contended that:

- (1) Mr J initiated, negotiated and concluded the purchase of shipping containers with various suppliers in Country T;
- (2) The suppliers issued invoices to Company A, but it was the staff of Company L in Country M who made payments to the suppliers on Company A's behalf;
- (3) Mr G initiated and negotiated the terms for the sale of shipping containers with Company AH by emails and telephone discussions from the Country Q;
- (4) Staff of Company L issued sales invoice together with certificates of ownership to Company AH. The shipping containers were picked up by the lessees after the shipping containers were sub-leased by

Company S;

- (5) Staff of Company L in Country M received payment from Company AH on behalf of Company S.

5.4 But despite the modus operandi of the Group and Company A as canvassed above, the Assessor did not accept Company A's offshore profit claim and raised 9 Profits Tax Assessments between 2008/09 to 2013/14. KPMG, on behalf of Company A, then objected to the Profits Tax Assessments and Additional Profits Tax Assessments on the ground that they were excessive. They contended that:

- (1) The effective causes leading to the generation of Company A's profits were the activities performed by the directors and relevant persons of the Group outside Hong Kong;
- (2) The trading profits were offshore sourced and not subject to Profits Tax, given that the initiation, negotiation, conclusion and execution of the purchase and sales contracts, the issuance and receipt of sales invoices, and the determination of the final settlement of accounts were all performed exclusively by the staff of the Group on behalf of Company A outside Hong Kong;
- (3) The leasing profits were offshore sourced and not subject to Profits Tax as the initiation, negotiation and conclusion of the Lease Agreement were all carried out outside Hong Kong, and the shipping containers were used outside Hong Kong;
- (4) The commission income was in substance part of the trading income for sales of shipping containers to Company AH. Since the relevant trading activities were all performed outside Hong Kong, the source of the commission income was also sourced outside Hong Kong;
- (5) The disposal gains of the aforesaid ISCs were offshore sourced, and hence, not subject to Profits Tax. When the shipping containers were unsold one year after the date of purchases, they would be reclassified from trading stock to ISCs as fixed assets for accounting purposes. As the sales and purchases contracts of the shipping containers were initiated, negotiated and concluded outside Hong Kong, the disposal gains were also offshore in nature.

5.5 KPMG further advanced the following arguments in relation to the functions performed and risks assumed by Company A:

- (1) Company A's directors and staff of the Group performed all the

following functions for Company A outside Hong Kong:

- (a) Company A determined whether shipping containers should be bought and traded;
 - (b) Company A evaluated and selected potential suppliers of shipping containers;
 - (c) Company A engaged unrelated third parties to perform inspection of shipping containers upon completion of manufacturing of the shipping containers;
 - (d) Through Mr E and Mr G, Company A maintained and managed business relationships with the customers;
- (2) It was not uncommon for directors to hold office in, and perform duties for, multiple entities within the Group. As long as they had the legal capacity to perform the activities of Company A, whether or not they were common directors of the Group's companies, such a fact should not jeopardize the trading activities performed by them on behalf of Company A outside Hong Kong.
- (3) Besides bearing the risk of holding the legal titles of shipping containers, Company A undertook certain risks of trading and leasing business:
- (a) Company A was subject to competition and general economic fluctuations of the container trading market;
 - (b) Company A bore all operating expenses such as storage, repair and maintenance and handling charges in case the shipping containers could not be leased out. It resorted to financing from Company U and Company V in case of having liquidity problems to meet operational expenses;
 - (c) Company A assumed various credit risks in case customers and/or lessees failed to pay up.

The Assessor's Determination

6.1 However, notwithstanding the aforesaid arguments, the Assessor still took the view that Company A's trading profits, leasing profits, commission income and disposal

gains of the ISCs were all profits arising in or derived from Hong Kong, and should be chargeable to Profits Tax. The Assessor further considered that the depreciation claimed in the accounts should be adjusted when computing the assessable profits. He suggested that the Profits Tax Assessments for the years of assessment from 2008/09 to 2010/11, and Additional Profits Tax Assessments for the years of assessment from 2011/12 to 2013/14 should be revised in the manner set out in Paragraph 21 of the Determination.

6.2 Accordingly, the Profits Tax Assessments and the Additional Profits Tax Assessments for the years of assessment from 2008/09 to 2013/14 under various Charges dated between Jan 2014 to Dec 2017 were either duly reduced, increased and/or confirmed.

The Commissioner's Reasons

7.1 In Section 3 of the Determination, the Commissioner set out his reasons for the Determination. The following issues were identified, namely, whether or not the following profits arose in or derived from Hong Kong, and should be chargeable to Profits Tax:

- (1) the profits from the buying of shipping containers, and the selling of shipping containers to investors;
- (2) the commission income relating to the sale of shipping containers to Company AH;
- (3) the leasing income from leasing shipping containers to lessees; and
- (4) the disposal gains of ISCs;

7.2 The Commissioner reviewed Section 14(1) of the IRO (Inland Revenue Ordinance, Chapter 112), which provides that 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. It is recognized and accepted that:

- (1) The ascertaining of actual source of income is a practical, hard matter of fact and no simple, single legal test can be employed (citing CIR v Orion Caribbean Ltd [1997] 1 HKLRD 924);
- (2) The broad guiding principle as laid down in CIR v Hang Seng Bank Ltd [1991] 1 AC 306 and expanded in CIR v HK-TVB International Ltd [1992] 2 AC 397 is that one looks to see what the taxpayer has done to earn the profit in question and where he has done it. It is necessary to have regard to the correct legal analysis of the transactions which yield the profits in question to the taxpayer (citing Kwong Mile

Services Ltd v CIR [2004] 7 HKCFAR 275).

- (3) In CIR v Wardley Investment Services (Hong Kong) Ltd [1992] 3 HKTC 703, the court ruled that it is the operations of the taxpayer which are the relevant consideration.
- (4) In ING Baring Securities (Hong Kong) Ltd v CIR [2007] 10 HKCFAR 417, Lord Millett NPJ said at paragraph 129 that:

‘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.’

7.3 The Commissioner took the view that Company A had carried on a business in Hong Kong, by reason of the following factors:

- (1) Company A was set up in Hong Kong as the trading arm of the Group which handled the Group's trading business in Asia, since Hong Kong was in close proximity to Mainland suppliers and with robust infrastructure and sound legal system;
- (2) Company A's business involved the buying of shipping containers from unrelated suppliers and selling of pooled shipping containers to customers, which were basically wholesale financial investors. To make them tradeable, the shipping containers were first leased to its related company, Company S, for sub-lease to third parties.

7.4 On the issue of the trading of shipping containers, the Commissioner was unable to subscribe to Company A's view, having considered that:

- (1) Company A maintained a registered office and principal place of business in Hong Kong. It did not have any establishment overseas, and there was no evidence that Company A carried on business outside Hong Kong;
- (2) Documents relating to the trading transactions (such as order confirmation, proforma invoices, portfolio request and invoices) issued by Company A bore the HK Address. Invoices from suppliers, Certificates of Inspection, Container Sale/Purchase Agreement with

suppliers were sent to Company A at the HK Address. Company A sent a letter to its supplier from the HK Address advising the settlement of the purchases. The APA and purchase contracts made with suppliers stipulated that any notice/invoice made to Company A had to be served to the HK Address. Invoices for management fees from Group companies were also issued to the HK Address.

- (3) No evidence was adduced that all the administrative work was performed outside Hong Kong by staff of the Group companies in Country M.
- (4) Staff cost was charged in the accounts of Company A throughout the years in question;
- (5) Company A also filed Employer's Returns in respect of Ms AJ, Ms AK and Mr AL for the year of assessment 2013/14. Pay slips of Mr AL showed that remuneration was paid to him directly by Company A. Upon enquiry, Company A claimed that they were erroneously done by the staff of the Group company. This cast doubt on Company A's allegation that it had no staff in Hong Kong and thus, no operations in Hong Kong.

7.5 On the issue of commission income from Company AH, the Commissioner observed that in 2011, Company AH agreed to make a one-off payment to Company A as commission for the years of assessment 2008/09 to 2013/14. Hence, the so called commission income was still derived from the sales transactions with Company AH, and was in substance part of the trading income from sales to Company AH under a different label. Hence, there is really nothing of substance to differentiate between the trading profits and commission income from the same customer as far as the sources of these profits or income are concerned. It therefore follows that the relevant commission income was trading profits sourced in Hong Kong and is also chargeable to tax in Hong Kong.

7.6 On the issue of leasing income, the Commissioner took the view that:

- (1) Although the activities which Company A had taken to earn the leasing profits and the trading profits were not the same, the leasing operation should still be considered as part and parcel of Company A's overall trading operation;
- (2) The source of the profits of Company A could not validly be ascribed to the activities of Company S, because:
 - (a) the operations of Company S for sub-leasing and the place where the shipping containers were used were irrelevant in determining the source of the leasing profits of Company A;

- (b) no evidence was provided to substantiate the claim that the activities which resulted in the earning of the leasing income were effected outside Hong Kong.

Hence, the Commissioner could not accept that the leasing profits were sourced outside Hong Kong, and the leasing profits should be chargeable to Profits Tax.

7.7 On the issue of disposal gains arising from ISCs, the reclassification of shipping containers unsold for one year as fixed assets in its financial statements was merely an accounting treatment to comply with relevant accounting standards. Apart from such a bare assertion, no evidence was provided by Company A to support the claim that the disposal gains of the ISCs sold to Company S was offshore in nature. Hence, they should also be regarded as sourced in Hong Kong and chargeable to tax in Hong Kong.

Section 14(1) of the IRO

8.1 Section 14(1) of the IRO provides that:

‘Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate 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.’

8.2 As rightly pointed out by Mr Mariani of Messrs Deacons for the Appellant, the legal issues of Section 14(1) to be determined by the Board are as follows:

- (1) **The 1st Issue:** whether Company A carried on a trade or business in Hong Kong; and
- (2) **The 2nd Issue:** if Company A did carry on a trade or business in Hong Kong, whether the profits of that trade or business arose in or were derived from Hong Kong.

8.3 It is not controversial that *Section 14(1)* can be further broken down into **3 Limbs** cumulatively, which must all be satisfied for a charge to profits tax to arise. First, a person must carry on a trade, profession or business in Hong Kong, which is the question that lies at the heart of the First Issue. Second, the person must derive Hong Kong sourced profits (that is, profits arising in or derived from Hong Kong). Finally, those Hong Kong sourced profits must be the profits of the specific trade or business carried on in Hong Kong. Since the 3 Limbs of *Section 14* are cumulative, it is only necessary for Company A to

succeed on either the First Issue or the Second Issue to be wholly successful in this appeal. And if any of the 3 Limbs were not met, no charge to profits tax may arise.

The 1st Issue / Locality Issue

9.1 The 1st Issue (or what is also referred to as the Locality Issue) turns on the question of whether Company A carried on a trade or business in Hong Kong. In the case of a body corporate, it has been said that any gainful use to which it puts its property may in principle amount to the carrying on of a business (American Leaf Blending Co. Sdn. BHD. v DGIR[1979] AC 676 at 684, per Lord Diplock). The threshold of being found to carry on a business in Hong Kong is therefore low. Indeed, Lord Diplock in American Leaf Blending opined that:

‘[t]he carrying on of ‘business’, no doubt, usually calls for some activity on the part of whoever carries it on [...]’.

9.2 Further, the Country Tan Court of Appeal in DEF v CIT [1961] MLJ 55, held in a statutory context analogous to that of the IRO that ‘carrying on’ a business implies a repetition or series of acts in the pursuit of commercial gain (at 59B – C, per Buttrose J).

Analysis on the Locality Issue

10.1 So, to identify where Company A carried on its trade or business, one must ascertain the locality where it conducted operations that put its assets to gainful (ie, profit-making) use. Company A's emphasis is that at all relevant times:

- (1) It did not have any employees, officers, agents, trading stock or other business assets located in Hong Kong;
- (2) It did not have a Hong Kong bank account either;
- (3) Company A only had a registered address and a Hong Kong resident company secretary, which are the bare minimum required of a company incorporated under the Companies Ordinance (Chapter 622). The Hong Kong registered address is akin to be mere ‘brass plate’.

10.2 However, in the case of Company A, there was no dormancy in the sense suggested above. Although the documentary evidence of activities in Hong Kong might be very minimal, some repeated activities in the pursuit of commercial gain had been carried on. It cannot be denied that:

- (1) In the notes to its financial statements, Company A had declared its HK Address as its registered office and principal place of business. Based on such declarations, Company L's invoices for its management fees were duly issued by Company L to Company A's HK Address, which

must also necessarily mean that the invoices had been deemed to have been received by Company A at its HK Address. For otherwise, a case could arguably be made out that Company A had never been properly notified that it had to settle its liabilities to Company L, which is not the case here;

- (2) The **3 Invoices** of Company A (shown in Appendix F of the Determination) issued to Company AH for USD6m, USD4m, and USD4m on 15 Dec 2011 and 28 Jun 2013, were for services rendered under the Container Advisory Agreement. They were all issued to Company AH in Company A's former name, Company B, at the HK Address;
- (3) The aforesaid Transaction 1 for 2008/09, involving Company AM as supplier and Company AH as purchaser, related to the APA entered into between Company A of the HK Address as buyer, and Company AM as seller, for the purchase of some shipping containers for some USD22.26m. The APA stipulated that any notices made to Company A had to be served to the HK Address;
- (4) The documents relating to trading transactions (such as order confirmation, proforma invoices, portfolio request and invoices) issued by Company A all bore the HK Address.
- (5) Invoices from suppliers, Certificates of Inspection, Container Sale/Purchase Agreement with suppliers were sent to Company A at the HK Address. Company A had sent a letter to its supplier apparently from the HK Address advising the settlement of the purchases.
- (6) The APA and purchase contracts made with suppliers also stipulated that any notice/invoice made to Company A had to be served to the HK Address;
- (7) Invoices for management fees from Group companies were also issued to the HK Address.

10.3 Considering the common ground that only a low threshold is required to satisfy the 1st Issue, the Board has no doubt that Company A did carry on a business in Hong Kong, given the evidence in particular, of those canvassed above. This holding need not be based on what Company A was, or what pre incorporation aspirations the Group had for Company A to be incorporated in Hong Kong, or what it had wrongly declared to have done in Hong Kong, but what was in fact done on its behalf by its agents, wherever they might be.

The 2nd Issue / Source Issue

11.1 Having arrived at the conclusion that Company A had indeed carried on a trade or business in Hong Kong, the next question concerns the 2nd Issue as to whether business carried on in Hong Kong was Hong Kong sourced (ie, arose in or be derived from Hong Kong) .

11.2 The law on the 2nd Issue (also known as the Source Issue) is not controversial. The question of profits source is, un-controversially, a hard, practical matter of fact to be understood not as a legal concept, but something which a practical man would regard as the real source of income (Rhodesia Metals Ltd (Liquidator) v CoT [1940] AC 774 at 789, per Lord Atkin).

11.3 The broad guiding principle in ascertaining the source of profits is that one should find what a taxpayer has done to earn the profit in question and where it has done it (CIR v Hang Seng Bank Limited [1991] 1 AC 306 at 322–323), discounting antecedent or incidental matters (Kwong Mile Services Ltd. v CIR, [2004] HKCU 782 at [12], per Bokhary PJ). The Judicial Committee of the Privy Council in CIR v HK-TVB International Ltd [1992] 2 AC 397 expanded (at 407) on the broad guiding principle, by articulating the so-called ‘operations test’ as follows:

‘F.L. Smidth & Co v Greenwood [1921] 3 K.B. 583 was cited in the Hang Seng Bank case and their Lordships do not doubt that Lord Bridge had in mind the judgment of Atkin L.J. in that case and in particular the passage when he said, at p. 593: ‘I think that the question is, where do the operations take place from the profits in substance arise? Thus Lord Bridge’s guiding principle could properly be expanded to read ‘one looks to see what the taxpayer has done to earn the profit in question and where he has done it Applying Lord Bridge’s guiding principles it is clear that the first question to be determined in this appeal is what were the transactions which produced the profit to the taxpayer’.

11.4 Similarly, in CIR v Orion Caribbean Ltd [1997] 1 HKLRD 924, Lord Nolan framed the ‘operations test’ thus:

‘[t]he proper approach is to ascertain what were the operations which produced the relevant profits and where those operations took place’ (at 930D – F).

11.5 In ING Baring Securities (Hong Kong) Ltd v CIR (2007) 10 HKCFAR 417, the Court of Final Appeal affirmed that the focus of an inquiry on the source of profits should be on the profit-producing transactions or operations themselves. One had to identify the proximate and actual cause of the profits. Bokhary PJ (as he then was) opined (at [38]) as follows:

‘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'.

11.6 Lord Millett (at 129) supplied the following observation:

'Lord Jauncey was plainly not intending to enunciate a different test from that stated by Atkin LJ. 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'.

11.7 The jurisprudence on the source of profits in Hong Kong is extensive, but for the purposes of this appeal, it can be distilled down to the following **3 key Principles** (see further ING Baring Securities at [6] – [7], per Chan PJ and at [35], per Ribeiro PJ; CIR v Datatronic Ltd [2009] 4 HKLRD 675 at [26] – [29], per Tang VP):

I The inquiry must turn on the nature of the operations or transactions which gave rise to the profits;

II The focus of the inquiry should be on the cause of the profits without being distracted by antecedent or incidental matters or activities amounting to technical assistance. And though such incidental or antecedent matters may, or will often be, commercially essential to the operation and profitability of the business, they are not relevant in ascertaining the source of the profits (see in particular Kwong Mile Services at [43]);

III Only the profit producing activities of the taxpayer should be taken into account, but not the activities of its affiliated companies, notwithstanding that they be in the same corporate group (Hang Seng Bank at 322H-323A, per Lord Bridge; HK-TVB at 407C and 409E; ING Baring Securities at [134]);

11.8 In the authorities reviewed above, there is nothing to suggest that a profit could originate in Hong Kong in the absence of something done by the taxpayer by way of operation, activity, or transaction in Hong Kong. In FCT v United Aircraft Corporation (1943) 68 CLR 525, Latham CJ, sitting on the High Court of Australia, said (at 536) that:

'[a] person who neither owns anything in a country nor does nor has done anything in that country cannot, in my opinion, derive income from that country'.

11.9 For an asset trade, the broad guiding principle provides that one has to look to where the contracts for the sale and purchase of the assets traded were effected (Hang Seng Bank at 323, per Lord Bridge). In that context, the term 'effected' has a broader meaning than merely 'executed'. It includes multiple stages of contract formation, such as negotiation, conclusion, and performance, and should not be construed mechanistically, but with reference to the specific facts of each case (CIR v Magna Industrial Ltd [1997] HKLRD 173 at 176 and 178 – 179, per Litton VP; Case D14/15 31 IRBRD 44 at [63]). This concept of effectuation, by its very nature, presupposes some positive act of the taxpayer or its agents taking place in Hong Kong for the contracts to be said to be effected in Hong Kong.

Analysis on the Source Issue

12.1 In the Determination, under the sub-head of 'Trading of shipping containers', the Commissioner contends in Paragraph 3(7), that his case is supported by, *inter alia*, the following factors:

- (1) The documents relating to trading transactions (such as order confirmation, proforma invoices, portfolio request and invoices) issued by Company A all bore the HK Address, as per Appendices G5, H1, H3, H12 and H13 thereto (paragraph (d)). However a scrutiny of all those documents suggest that although they were apparently created in Company A's name at the HK Address, they might not have been so created by anyone engaged in Hong Kong. Appendices H1 and H3 show that they were issued by Mr J on behalf of Company A. And according to the evidence of Mr E, Mr J and Mr G, who were ordinarily resident outside Hong Kong, did not ever visit Hong Kong for the purposes of negotiating or concluding any agreements with suppliers and investors insofar as he was aware. Further Appendix H12 shows that it was signed by another non-resident of Hong Kong on Company A's behalf, Mr G. *Prima facie*, the signature corresponds with that of his Affidavit;
- (2) No evidence was adduced that all administrative work was performed outside Hong Kong by staff of the Group companies in Country M (paragraph (e));
- (3) Staff cost was charged in Company A's accounts throughout the years in question (paragraph (e)). The point here is that because staff costs had been undeniably incurred by Company A, it suggests that Hong Kong staff had been engaged to run the business here. However, according to Mr E's testimony, these were merely intra group payments

from Company A to Company L. And a scrutiny of the documents relating to staff costs show that these were also called management fees: 'Management fees classified as "Staff costs"'. But counsel for the Commissioner, Mr Ernest Ng, takes issue with such an assertion. In the Respondent's Closing Submissions of 3 Jun 2020, he pointed out that whereas staff costs correspond to the financial statements, management fees do not. Hence, there appears to be some substance in the allegation that management fees indeed were loosely documented intra group transactions that need not be audited, whereas staff costs were not,

12.2 However, the Commissioner had made one point in Paragraph 3(7)(e), which lends great credence to the view that Company A had indeed operated in Hong Kong, at least through the **Trio** of Ms AJ, Ms AK and Mr AL, said to be staff of Company N HK Branch. There is found an **LOU** (Letter of Understanding) dated 1 Apr 2013 where, *prima facie*, Ms AJ, who was said to have a contract with Company N HK Branch since 1 May 2001, was offered the position of North East Asia Operations Supervisor with Company A to commence forthwith on 1 Apr 2013, reporting to Mr AL. It was signed by **Mr AP**, Human Resources Director for 'Company A', at Address AQ. Her normal working location was also stated to be at Address AQ, but might be required to work from other locations. Her normal working hours were 9am to 6pm, Mon to Fri with an hour for lunch. She would not be required to travel to work where Black Rainstorm Warning or Typhoon Warning No.8 or above was raised. Her main responsibilities were said to be detailed in her 'Position Description', which might already have been provided, in which case, it would not accompany the LOU.

12.3 *Prima facie*, a number of natural inferences can reasonably be made from the contents, unless contrary evidence is adduced to negate them (of which the Board is not made aware):

- (1) Ms AJ had been employed since 1 May 2001 for almost 12 years by Company N HK Branch, but was required to change employer to Company A, with immediate effect on 1 Apr 2013, apparently with some urgency;
- (2) Mr AP also stood in for Company A as its Human Resources Director. He signed it in Hong Kong, not in Country M or Country T. No evidence had been adduced that he signed it outside Hong Kong;
- (3) Mr AL was Ms AJ's superior, who also worked for Company A;
- (4) The document was procured in Hong Kong not in Country M or Country T, because the draftsman, far from being unversed in local praxis, at least knew enough about Hong Kong's typhoon warning signals;
- (5) Company A and Company N HK Branch shared the same operational

office at Address AQ, notwithstanding that Company A's only purportedly known registered address or place of business was the HK Address of Company Z, Company A's company secretary.

12.4 Mr AR's testimony seeks to explain that the LOU as a mistake detected by the 'executive management of the Group C', and that the mistake was rectified by causing Company A, Company N HK Branch and Ms AJ to revert to her previous employment. And as a result, a **Rectification Agreement** dated 6 Nov 2014 was entered into [A/38/20]. He said the mistake was a 'confusion in the identity of the employer', and that the error might have been caused by 'a lack of familiarity with employment laws and administrative praxis of other jurisdictions'.

12.5 However, the Board has great difficulty in understanding how ignorance of foreign employment laws and administrative practices could possibly lead to a deliberate decision to require a foreign employee to cease employment with one employer after having worked for almost 12 years, and then to commence employment with another employer forthwith. A decision of such a nature would normally have arisen because of a pressing intra corporate need to do so, and not because of an ignorance of local laws and commercial practice. Further, it could not have arisen because of a confusion of identities, as if to strangely suggest that an entire department in Country M thought that Ms AJ had worked for Company A for 12 years before she was commandeered to work for Company N HK Branch instead.

12.6 Besides the above difficulty, the Board has another difficulty in understanding how the error really came to light. Mr AR's account inevitably suggests that Ms AJ, Company A and Company N HK Branch had all been oblivious to the error day in and day out for at least 19 months at Address AQ, until a more astute executive management of the Group at an unspecified location detected the mistake. The Board has no good valid grounds to accept Mr AR's suggestion of 19 months of ignorance and confusion amongst locals as convincing.

12.7 Mr Ng has also drawn the Board's attention to an **Original Agreement** of employment dated 1 May 2001 between Ms AJ and Company N HK Branch where her job description was stated to include:

- (1) '1. Manage the container activities in HKG, China and the Far East';
- (2) '5. Coordinate and communicate effectively with factories and depots for all leasing activities';
- (3) '6. Coordinate and work effectively with factories on container productions vs. delivery arrangements'.

12.8 So *prima facie*, her 12 years of employment with Company N HK Branch between 1 May 2001 and 31 Mar 2013 required her to directly deal with Asian trading and leasing activities of the Group in Hong Kong. That undermines Company A's case that she only provided administrative services to Company S, but fortifies the Commissioner's case

that she was actually mandated to deal with trading and leasing matters in Hong Kong for the Group including Company A, for the change of employer was supposed to be caused by purported mistaken identity or unfamiliarity with local laws and practices, not a change of employment responsibilities.

12.9 The Rectification Agreement also presents other problems. It recites that Company A had entered into an employment agreement with Ms AJ ‘due to a misinterpretation of the main purpose of [Company A]’. It suggests that the mis-interpreter was Company A itself, not someone in the Human Resources Department in Country M who had even overlooked the existence of Company N HK Branch altogether (as claimed in Company A's letter to the Assessor of 1 May 2016). It also *prima facie* suggests that Company A had erroneously misunderstood its role in Hong Kong, and had to rectify the misunderstanding. But to admit here that Company A misinterpreted the role it was supposed to play in Hong Kong, also implies that it had nevertheless played a role, albeit wrongly. Again, this undermines Company A's case that it had no Hong Kong business activities, and supports the Commissioner's case that it had.

12.10 Regarding Ms AK, the Board's attention is drawn to 2 crucial emails sent to her by Mr AR. It can readily be seen that in an email dated 19 Sep 2013, and another email dated 18 Dec 2014, she was also entrusted with tasks relating to the trading and leasing of containers in considerable detail, but without reference to Company S. There is thus, *prima facie* evidence that these matters were conducted for Company A in Hong Kong.

12.11 Apart from the above, there is further evidence that Mr AP had also wrongly signed Company A's Employer's Returns not just for Ms AJ, but also for Ms AK, and Mr AL, all dated 9 May 2014. These purported U turns suggest that Company A had indeed regretted in engaging its own employees in Hong Kong to conduct its business, as opposed to borrowing employees of Company N HK Branch to do so. But it took Company A 19 months of trial run at Address AQ to realize the error of its new thinking, and to revert to its old ways to undo the damage. This, more than anything else (such as innocent conceptual mistakes), explains why there was a spell of 19 months of misguided strategy over a period of 6 assessment years from 2008/09 to 2013/14.

12.12 The absurdity of these alleged innocent mistakes calls into question Company A's credibility on the Source Issue so seriously that it would require a very brave Board to endorse Company A's case that it had done nothing in Hong Kong to earn its profits, and that they were all effectuated by intra corporate agents in Country T and Country M.

13.1 But for completeness sake, the Board shall also deal with the issues specifically relating to leasing activities. Mr Ng in the Respondent's Closing Submission, has argued that insofar as leasing profits are concerned, KPMG, on Company A's behalf, had admitted that they are ‘part and parcel’ of its ‘trading activities’, and that such a formulation had been accepted by the Commissioner without any further objection from Company A. Mr Ng's point is that this is in flat contradiction to one of Company A's repeated contention that leasing activities were distinct from trading activities. However, the Board does not see such an apparent contradiction of characterization as adverse to Company A's

fundamental tenement that neither trading activities nor leasing activities which generated profits were carried on or sourced in Hong Kong.

13.2 The more pertinent point regarding leasing activities is that although KPMG's letter to the Commissioner dated 10 May 2013 had alleged that the Lease Agreement dated 1 Jul 2009 between Company A as lessor and Company S as lease (with retrospective effect to 1 Nov 2008), was signed by Mr G in the Country Q and Mr H in Country T, the evidence in support thereof is inadequate. Whereas the Lease Agreement expressly stated Mr H's execution in Country T, the same cannot be said about Mr G's execution in the Country Q, for there was no mention of his locality of execution.

13.3 The Board has also appreciated that in testimony, Mr G did not go so far as to expressly say that he actually signed the Lease Agreement in the Country Q. The relevant parts of his depositions in his **Affidavit**, which he adopted as his evidence in chief, were either in general terms, or did not specifically relate to the jurat of the Lease Agreement. He said:

- (1) in Paragraph 4, that, *'At all material times I was resident in the Country Q or in any event outside of Hong Kong. I am not and have never been a Hong Kong permanent resident, nor was I at any time ordinarily resident in Hong Kong.'*
- (2) in Paragraph 12, that, *'During the relevant period, I did not at any point visit Hong Kong for any business purposes. As far as I can recall, I did not initiate, negotiate, conclude or execute any contract or agreement for either the purchase or sale of containers in Hong Kong';*
- (3) in Paragraph 15, that, *'I confirm that I concluded and executed each of the abovementioned agreements [i.e., the Container Advisory Agreement between Company A/Company B and Company AH, and a related Portfolio Request] for and on behalf of Company A outside of Hong Kong. Although the address referenced for Company A was in general the address of its registered office in Hong Kong, nothing was actually done by Company A at that address or, indeed, anywhere else in Hong Kong';*
- (4) in Paragraph 16, that, *'All communications and negotiations I entertained with Company AH took place outside of Hong Kong; as I have already mentioned, I did not at any material time travel to Hong Kong for reasons connected with Company A's trade. There was no need for me to do so, as none of Company A's Investors for the relevant period had their principal place of operation in Hong Kong. Company A further did not at any material time have a Hong Kong Investor'.*

Hence, insofar as the Lease Agreement between Company A and Company S is concerned, Mr G's purported execution thereof in the Country Q is either not sufficiently proven or at best inconclusive.

13.4 Although, arguably, the above evidential inadequacies of the Lease Agreement may not be critically detrimental to Company A's case, the Board has observed that the significance of Clause 1(b)(iii) thereof cannot be ignored, and in all likelihood, is most indicative of the truth which undermines Company A's case. It expressly declared that:

'the Lessor and the Lessee agree (A) to treat the transactions contemplated by this Agreement as a true lease of the Lessor Containers by the Lessor to the Lessee for Hong Kong Profits Tax purposes, and Country T income tax purpose, and (B) to cooperate and take positions consistent with such treatment in filing their respective Hong Kong Profits Tax and Country T Income Tax returns, if any.'

The Board takes the view that this Declaration is fatal to Company A's appeal, for it compellingly implies that Company A had historically treated and committed the profits from its leasing activities as chargeable to profits tax, and to take any contrary position in this appeal would be most uncooperative and inconsistent with the only fair inference of such a Declaration.

Conclusion

14. For all the above reasons, the Board cannot reasonably accept with sustained conviction that Company A has discharged its onus of proving that the assessment appealed against is incorrect, as required under Section 68(4) of the IRO. This appeal is therefore dismissed, and the Board makes an order confirming the Determination that Company A's profits are chargeable to profits tax. And pursuant to Section 68(9) of the IRO, the Board orders Company A to pay as costs of the Board in the sum of \$20,000, which shall be added to the tax charged and recovered therewith.