

Case No. D27/22

Profits tax – Source of profits – whether profits wholly derived outside Hong Kong – no witness called to explain documents – late submission of documents – whether burden of proof discharged – sections 2, 14 and 68 the Inland Revenue Ordinance (‘IRO’)

Panel: Chui Pak Ming Norman (chairman), Tong Sidney Pui Keung and Wong Kin Yan Vanessa.

Date of hearing: 21 November 2022.

Date of decision: 13 January 2023.

The Appellant was a private company incorporated in Hong Kong. It stated its principal activity as providing ‘evaporator design, marketing development and consulting services’ in a place outside Hong Kong. The Appellant furnished its Profits Tax Returns respectively for the 2012/13 to 2015/16 years of assessment, claiming that it had no assessable profits after excluding ‘offshore’ profits totalling over HK\$14 million. It did not respond to the enquiry sent by the Assessor. In view of the lack of reply, the Assessor raised profits tax assessments, treating all ‘offshore’ profits as assessable. The Appellant again failed to submit any documents as invited when objecting against the assessments. The Acting Deputy Commissioner confirmed the assessments by way of his Determination. It was only after the Determination was issued that the Appellant sent documents purporting to answer the enquiry of the Assessor. Afterwards, the Appellant appealed against the Determination. The Appellant did not submit any document or witness statement by the deadline directed by the Board. At the hearing, the Appellant did not call any witness to give evidence, but applied to admit a bundle of documents as evidence. It explained the lateness by the lack of consent given by third parties to release contract documents. Moreover, the Appellant further suggested at the hearing that all the profits were generated from interpretation service provided outside Hong Kong. The agreed facts before the Board showed that the Appellant maintained 2 bank accounts in Hong Kong and it received service fee from customers by these accounts; it had a registered office in Hong Kong and its financial statements were audited by certified public accountants in Hong Kong.

Held:

- (1) The Appellant failed to provide any good reason for admitting its documents as evidence out of time. Even assuming documents relating to third parties were subject to confidentiality, the Appellant could have submitted other documents not subject to confidentiality much earlier, eg witness statements from its directors or a full set of its bank statements. It would be unfair to the Commissioner to allow the late

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admission of documents as he would not be able to properly consider the Appellant's offshore claim.

- (2) It was incredible that the Appellant could earn such profits simply by providing interpretation service. In the absence of any explanation from any witness, it was not possible for the Board to conclude from the admissible documents what the operations were that produced the Appellant's profits, and where those operations were carried out (CIR v Hang Seng Bank Limited [1991] 1 AC 306; CIR v HK-TVB International Limited [1992] 2 AC 397; ING Baring Securities (Hong Kong) Ltd v CIR (2007) 10 HKCFAR 417 considered). The Board could not act on the Appellant's bare allegations (D8/16 (2016-17) IRBRD, vol 31, 502 at paragraph 19 citing D14/08 (2008-09) IRBRD, vol 23, 244 at paragraph 52 and 53 and D45/10 (2011-12) IRBRD, vol 26, 21 at paragraph 18 followed). As a result, the Appellant failed to discharge the burden of proof to show that the assessments were wrong (CIR v Common Empire Limited (No.2) [2007] 3 HKLRD 75 at 89I; Kim Eng Securities (Hong Kong) Ltd v Commissioner of Inland Revenue (2007) 10 HKCFAR 213; Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue (2008) 11 HKCFAR 433; Commissioner of Inland Revenue v Crown Brilliance Ltd [2016] 3 HKC 140 followed).
- (3) The evidence submitted by the Appellant was flimsy and vague. Directions given by the Board was not complied with. The Appellant's dilatoriness in responding to the Commissioner's request for documents incurred unnecessary public fund. Thus, it was suitable to order the Appellant to pay the costs of the Board.

Appeal dismissed and costs order in the amount of \$15,000 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 Common Empire Limited (No.2) (2007) 3 HKLRD 75
Kim Eng Securities (Hong Kong) Ltd v Commissioner of Inland Revenue (2007) 10 HKCFAR 213
Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue (2008) 11 HKCFAR 433
Commissioner of Inland Revenue v Crown Brilliance Ltd [2016] 3 HKC 140
D8/16, (2016-17) IRBRD, vol 31, 502
D14/08, (2008-09) IRBRD, vol 23, 244

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D45/10, (2011-12) IRBRD, vol 26, 21

Yip Hak Ping Myron, instructed by Excellence Company, for the Appellant.
Yau Yuen Chun, Fung Chi Keung and Ching Wa Kong, for the Commissioner of Inland Revenue.

Decision:

Introduction

1. The Appellant in its profits tax returns for the years of assessment 2012/13 to 2015/16 declared that all its profits were derived outside Hong Kong.

2. The Respondent by its letter dated 5 March 2019 (“Enquiry Letter”) requested the Appellant’s tax representative (Excellence Company, the “Representatives”) to provide information and supporting documents to substantiate the offshore claim. Pending the reply from the Representatives and in order to protect the revenue, the assessor respectively issued to the Appellant the profits tax assessments for year of assessment 2012/13 dated 8 March 2019 and profits tax assessments for year of assessment 2013/14 dated 9 March 2020.

3. By its letters respectively of 6 December 2019 and 24 February 2020, the Respondent followed up with the Representatives for its reply to the Enquiry Letter. In absence of a reply to the Enquiry Letter by the Representatives, the assessor respectively issued to the Appellant the profits tax assessments for year of assessment 2014/15 dated 19 March 2021 and profits tax assessment for year of assessment 2015/16 dated 15 February 2022.

4. The Appellant objected to the profits tax assessments for the aforesaid four years of assessment, namely, years of assessment 2012/13 to 2015/16 raised on it. The Appellant claims that its income for the aforesaid years of assessment was derived outside Hong Kong and should not be chargeable to Profits Tax.

5. Having considered the objection, the Acting Deputy Commissioner of Inland Revenue issued his determination dated 5 July 2022 (“Determination”) on the objection whereby the following assessments were confirmed:

- (i) Profits Tax Assessment for the year of assessment 2012/13 under Charge Number X-XXXXXXXX-XX-X, dated 8 March 2019, showing Assessable Profits of \$4,133,608 with Tax Payable thereon of \$672,045;
- (ii) Profits Tax Assessment for the year of assessment 2013/14 under Charge Number X-XXXXXXXX-XX-X, dated 9 March 2020, showing Assessable Profits of \$7,152,798 with Tax Payable thereon of \$1,170,211;

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- (iii) Profits Tax Assessment for the year of assessment 2014/15 under Charge Number X-XXXXXXX-XX-X, dated 19 March 2021, showing Assessable Profits of \$884,580 with Tax Payable thereon of \$125,955; and
- (iv) Profits Tax Assessment for the year of assessment 2015/16 under Charge Number X-XXXXXXX-XX-X, dated 15 February 2022, showing Assessable Profits of \$2,258,764 with Tax Payable thereon of \$352,696.

6. Soon after the issuance of the Determination on 5 July 2022, the Representatives sent a letter dated 8 July 2022 purportedly to supply the information requested in the Enquiry Letter for the Respondent's consideration, in which certain documents were annexed. It should be noted that this was the first occasion that the Appellant provided supporting documents to the Respondent for consideration but it was made after the Determination was issued.

7. After providing the aforesaid documents to the Respondent, the Representatives on 4 August 2022 lodged an appeal to the Board of Review ('Board') under section 66 of the Inland Revenue Ordinance (Chapter 112)('the IRO') against the Determination.

Grounds of Appeal

8. The ground of the appeal raised by the Appellant in its letter of 4 August 2022 or notice of appeal is that the profits were wholly derived outside Hong Kong and should not be chargeable to Hong Kong Profits Tax.

9. In support of the Appellant's claim that the profits were wholly derived outside Hong Kong, the Representatives annexed a number of documents which are annexed in the B1 Bundle.

10. For easy of reference, we set out the documents sent in each occasion by the Representatives as below:

	<u>Documents sent on 8 July 2022 to the Respondent by the Representatives</u>		<u>Documents sent on 4 August 2022 to the Board by the Representatives</u>
1	Letter of the Tax Representative dated 8 July 2022 with confirmation of Ms A	1	Letter of the Tax Representative dated 4 August 2022 with confirmation of Ms A
2	Organization Chart of the Appellant	2	Company B Contract dated 15 March 2022 made amongst Company C, Mr D and the Appellant on different dates of

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			April 2010 (*)
3	A tax payment receipt (but the contents thereof are blurred and difficult to read)	3	Supplemental Business Cooperation Contract made by the same parties on different dates of April 2013 (*)
	<u>Documents sent on 8 July 2022 to the Respondent by the Representatives</u>		<u>Documents sent on 4 August 2022 to the Board by the Representatives</u>
4	Relevant pages of the US Passport of Ms A	4	Invoice of the Appellant to Company C dated 22 September 2015
5	Relevant pages of the US Passport of Mr E	5	Invoice of the Appellant to Company C dated 15 September 2015
6	Company B Contract dated 15 March 2022 made amongst Company C, Mr D and the Appellant on different dates of April 2010	6	Invoice of the Appellant to Company C dated 30 June 2013
7	Supplemental Business Cooperation Contract made by the same parties on different dates of April 2013	7	Invoice of the Appellant to Company C dated 29 January 2013
8	Invoice of the Appellant to Company C dated 14 December 2017	8	Relevant pages of the US Passport of Ms A (*)
9	Invoice of the Appellant to Company C dated 18 March 2018	9	A tax payment receipt (but the contents thereof are blurred and difficult to read)(*)
10	Relevant pages of the PRC Passport of Ms F		

(*) the documents sent were same as those sent on 8 July 2022

Issues

11. The issues for the Board to determine are therefore (i) what were done by the Appellant to earn the income and profits in the material period; and (ii) where did the Appellant provide the service for the purpose of earning the incomes in the material period.

Facts of the Case

12. The following facts stated in the Determination, which was not contested or objected to by the Appellant, form parts of the facts of the Appeal: -

- (1) The Appellant has objected to the Profits Tax Assessments for the years of assessment 2012/13 to 2015/16 raised on it. The Appellant claims that its income was derived outside Hong Kong and should not be chargeable to Profits Tax.
- (2) (a) The Appellant was incorporated as a private company in Hong Kong in 2008. It closed its annual accounts on 31 March.
(b) The Appellant’s principal activity as stated in its report of the directors was ‘provision for evaporator design, marketing development and consulting services in the Mainland’.
- (3) The Appellant furnished its Profits Tax Returns for the years of assessment 2012/13 to 2015/16 (‘the Returns’) together with its audited financial statements and profits tax computations for the period from 23 January 2008 to 31 March 2013 and the years ended 31 March 2014 to 2016.
(a) According to its profits tax computation for the year of assessment 2012/13, the Appellant commenced business on 1 April 2012 and the basis period for the year of assessment 2012/13 was from 1 April 2012 to 31 March 2013.
(b) In the Returns, the Appellant declared that it had no assessable profits for the years of assessment 2012/13 to 2015/16 after excluding the following ‘offshore’ profits:

<u>Year of assessment</u>	<u>2012/13</u>	<u>2013/14</u>	<u>2014/15</u>	<u>2015/16</u>
‘Offshore’ profits	\$4,133,608	\$7,152,798	\$884,580	\$2,258,764

(c) The Appellant’s income statements for the period from 23 January 2008 to 31 March 2013 and the years ended 31 March 2014 to 2016 showed the following particulars:

<u>For the period/year ended</u>	<u>31-03-2013</u>	<u>31-03-2014</u>	<u>31-03-2015</u>	<u>31-03-2016</u>
	\$	\$	\$	\$
Commission and service income	4,157,535	7,180,062	913,406	2,288,695

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Bank interest income	6	22	6	1
Profit on exchange	-	235	-	19
	4,157,541	7,180,319	913,412	2,288,715
<u>Less:</u> Administration and general expenses	23,927	27,499	28,826	29,950
Profits before tax	4,133,614	7,152,820	884,586	2,258,765

- (4) The Assessor requested the Appellant to provide information and documents to substantiate its claims, including its business establishment, a detailed description of the functions it carried out to earn the service income and a full indexed set of transaction documents concerning its service income.
- (5) The Assessor did not receive the information and documents requested in Fact (4) from the Appellant. She raised on the Appellant the following Profits Tax Assessments for the years of assessment 2012/13 to 2015/16:

<u>Year of assessment</u>	<u>2012/13</u>	<u>2013/14</u>	<u>2014/15</u>	<u>2015/16</u>
	\$	\$	\$	\$
Profits before tax [Fact (3)(c)]	4,133,614	7,152,820	884,586	2,258,765
<u>Less:</u> Bank interest income [Fact (3)(c)]	6	22	6	1
Assessable Profits	4,133,608	7,152,798	884,580	2,258,764
Tax Payable thereon	672,045	1,170,211	125,955	352,696

- (6) The Appellant, through the Representatives, objected to all the assessments in Fact (5) claiming that its profits were earned from its operations outside Hong Kong and should not be chargeable to Profits Tax.
- (7) Despite repeated requests, the Assessor has not received the information and documents requested in Fact (4) from the Appellant or the Representatives.

Application for Admitting Documents submitted by the Appellant at the Hearing

13. Mr Yip Hak-ping Myron of the Representatives ('Mr Yip') attended the hearing representing the Appellant. Mr Yip did not call any witness to testify on behalf of the Appellant. He made an application to the Board for admitting a bundle of documents contained in the bundle known as Bundle soon after the commencement of the hearing.

14. The Respondent represented by Ms Yau Yuen-chun ('Ms Yau') objected to the application on the ground that it was a late application. She submitted that the Respondent did not have sufficient time to consider and comment the same, or to investigate whether the documents were true or genuine or not if the documents were admitted in the morning of the scheduled hearing. It was therefore not fair to the Respondent if the documents were admitted.

15. The grounds relied on by Mr Yip to support his application were that (1) it took time to obtain the documents or to have consent from the counterparties of Company C to disclose its agreements for the reason of confidentiality of the contents of the relevant agreements; (2) he only obtained the documents on last Saturday (28 November 2022); and (3) Company C had to contact a number of customers for their consent.

16. Before the Board made a decision on the Appellant's application for admission of the documents as evidence during the hearing, the Board had to consider the following accounts of facts:

- (a) After the objection was received by the Respondent, the Respondent repeatedly asked the Appellant to provide documents or explanations for their consideration the claim of offshore profit. However, the Appellant refused or failed to respond to the Respondent's request. As such the objection was rejected by the Commissioner *inter alia* on the ground that the Appellant has not provided the requested information and documents to substantiate its claim.
- (b) After the Appellant lodged its appeal with the Board on 4 August 2022, the Respondent took the liberty to issue a follow-up enquiry on 8 September 2022 asking the Appellant to provide documents to support its claim but no reply was given by the Appellant.
- (c) As to the Appeal, the Board on 13 September 2022 made *inter alia* the following directions regarding the documents to be submitted by the Appellant:

'7. that a bundle of all documents (together with the English translation of such documents if they are not written in English) which the Appellant wishes to rely on, including but not limited to opening submissions, witness statements of any witness the Appellant intends to call, any authority the Appellant wishes to cite in support of the appeal etc., shall be printed double-sided and paginated..... By 3 November 2022, 1 copy should be sent to the Commissioner's

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representative, and the remaining 6 copies should be sent to the Board of Review’.

- (d) No documents were sent by the Appellant on 3 November 2022 as directed by the Board. No application for extension of time to file documents was sought by the Appellant. To put it simple, the Appellant just ignored the direction unless it is the Appellant’s intention not to submit further documents.

17. We feel that ‘late application’ being the application made at the hearing date is a sufficient and legitimate ground to refuse the Appellant’s application to admit documents unless the Respondent could provide good reason(s) to justify its late application. In order that it was fair to the Appellant, we felt therefore that it was necessary for us to listen and consider whether there were special grounds which caused the lateness and whether the documents could assist the Board to resolve the issues.

18. As to the reason of lateness, Mr Yip relied on the grounds submitted at the hearing.

19. Amongst the documents in the Bundle, there was a letter from the Representatives to the Respondent dated 19 November 2022 which was counter-confirmed by Ms A (‘November Letter’).

20. In the November Letter the Representatives alleged *inter alia* that:

- (a) Mr E has no business operation with the Appellant and he takes the position of director only (Paragraph 1 of the November Letter).
- (b) Ms A always stayed in Mainland to work for provision of evaporator technical support to Company C when Company C’s client requested the solution of evaporator equipment (Paragraph 1 of the November Letter).
- (c) There was no successful order from Company C’s client during the period from 15 March 2010 to 31 August 2012. A sample invoice dated 1 September 2012 from the Appellant to Company C was attached (Paragraph 2 of the November Letter).
- (d) The service incomes of the Appellant from different clients of Company C for the period from the financial year 2012/13 to 2015/16 were set out (Paragraph 3 of the November Letter).
- (e) The Appellant had no commission income as the Appellant had no customers referral provided to Company C. The Appellant was only the provision of evaporator technical support (sic.) (Paragraph 4 of the November Letter).

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- (f) The design service was provided by Mr D. The related technical support service was provided by the Appellant (Paragraph 3 of the November Letter).
- (g) The Appellant was only the provision of evaporator technical support (sic). In this connection, the Representatives referred to other sections of the November Letter (Paragraph 4 of the November Letter).
- (h) The design services were provided by Mr D. The invoices were issued by Mr D to Company C directly. The Representatives referred to sample stated in Paragraph 6 of the November Letter (Paragraph 5 of the November Letter).
- (i) The provision of marketing consulting services is merely the provision of evaporator technical support in the Mainland (Paragraph 6 of the November Letter). The Representatives refer to the attachment (B) of the sample of largest amount of service for details of illustration.
- (j) The Representative annexed sample receipt of tax paid in Mainland by Company C for the Appellant. They referred to attachment (C) for the basis of calculation of the Mainland tax RMB 92,463.43 in the tax receipt dated 24 September 2014 (Paragraph 7 of the November Letter).
- (k) the Representative alleged that (a) Mr D has no relationship with the Appellant's directors and shareholder; (b) Mr D has no relationship with Mr F. The Representatives referred the Respondent to attachment (D) (Paragraph 8 of the November Letter).

21. The annexures referred to the November Letter consisted *inter alia* of some written explanations, calculation, photos, charts, invoices, and other documents. The explanatory notes were not signed by the writer. In the absence of a witness statement or oral evidence from the Appellant, it was difficult, if not impossible, for the Board or the Respondent to understand the documents fully. Even if the Board could understand or guess the contents of the documents, there remained the issues that in the absence of any cross-examination, it was difficult for the Board to evaluate their evidential values.

22. Without going into details of the documents annexed in Bundle, the Board noted the allegation that there were only 2 directors of the Company. In the November Letter, Mr Yip stressed that Mr E had no role in the Company and Ms A always stayed in Mainland to work for provision of evaporator technical support to Company C when Company C's client requested the solution of evaporator equipment. We have reservation on this claim.

23. In relation to Mr E, the Board needed to know why Mr E had no role in the business operation, in particular in Hong Kong as he had stayed in Hong Kong for 282 days

during the material period (ie 119 days in year 2012/13, 92 days in year 2013/14, 65 days in year 2014/15 and 6 days in year 2015/16)¹. The Board could not accept the mere allegation of Mr Yip that the Appellant's directors Mr E had not rendered any service on the contract in which the Appellant earned its income. The Board could and might only do so after the Board had a chance of evaluating this allegation with reference to the oral testimony of the relevant witness called by the Representatives at the hearing. However, such oral testimony was not forthcoming.

24. The Representatives alleged that Ms A stayed in Mainland to work for provision of evaporator technical support to Company C when Company C's client requested the solution of evaporator equipment.

25. The claim of 'always stayed in Mainland to work for provision of evaporator technical support' suggested that she would not provide such services in Hong Kong. In this connection, the Representatives submitted her US Passport for the Board's consideration. Mr Yip submitted that her Passport could show that in the material period Ms A was not in Hong Kong. However, according to the records kept by the Immigration Department, Ms A had 20 days in Hong Kong during the material period (ie 3 days in year 2012/13, 13 days in year 2013/14 and 4 days in year 2014/15)². It might be true or not true that Ms A rendered all services to the client of Company C outside Hong Kong given the conflicting information. In the absence of the oral testimony of Ms A (which would be subject to the Respondent's cross-examination), the Board simply could not draw any conclusion in this regard purely from the documents in Bundle.

26. Amongst the documents in Bundle, there was a Bank G bank statement (9 October 2014) in respect of the Appellant's account maintained with them. We did not feel that this bank statement was subject to any confidentiality restriction as this bank statement did not concern others. However, the Appellant saw fit to annex only page 2 of 2 and withheld page 1 of 2 of this statement from the Board.

27. There was another Bank G bank statement dated 9 November 2013. It consisted of 3 pages. Yet the Appellant saw fit to annex only Page 2 of 3 in the Bundle. It withheld the other two pages from the Board. We did not know whether the complete bank statements might contain materials against the Appellant. We did not know the reason why the Appellant was not willing to annex all the bank statements issued by the banks in the material period for the Board's consideration. However, one thing which the Board knew very well was that the Board should not be asked to guess the contents or to draw inference or conclusion from incomplete documents.

28. The sample invoice issued by the Appellant to Company C for payment and dated 21 September 2014 recorded that it was for 'Market Service Fee'. In the November Letter, the Representatives submitted that the service was for provision of evaporator technical support to Company C and that the Appellant had no commission income as the

¹ The arrival and departures dates of Mr E based on records from the Immigration Department.

² The arrival and departures dates of Ms A based on records from the Immigration Department.

Appellant had no customers referral provided to Company C. The Representatives' claim apparently contradicted the contents of the invoice.

29. The calculation of incomes as well as the verbal descriptions on the charts or explanation notes were not signed.

30. In the absence of explanation on the doubts or queries arising from the documents by the Appellant's witness, the Board was of the view that the prejudicial effects of those documents, if they were admitted, would outweigh any probative values they might have.

31. Mr Yip stressed that the lateness of application was due to the in-cooperation or refusal of the consent of Company C's customers because the contracts to be disclosed were subject to confidentiality. We did not accept that it was a good reason. If the contracts with third parties were subject to confidentiality issue, the Appellant could submit other documents which were not subject to confidentiality claim much earlier prior to the hearing. For example, the Appellant could file and serve the witness statements of the directors of the Appellant to give explanations on the documents. The Appellant could submit the full set of bank statements from two banks covering the whole material period. Those documents were not subject to the claim of confidentiality. Even if some documents might have some confidential information, the Appellant could black them out before filing.

32. Mr Yip claimed that Ms A was always in the Mainland and the operation of the Appellant was therefore in the Mainland. It follows that the Appellant could not be prevented from entering the Mainland to locate documents as it claimed in the previous correspondence. We did not find there was any reason to justify the Appellant to make such a late application.

33. We noted the Respondent's earlier submission made in its letter to the Board of 4 November 2022 (with copy also to the Representatives) that the failure of the Appellant reply to the Respondent in a timely manner operated to remove from the Respondent's hands altogether the task of properly considering the taxpayer's offshore claim and purporting to place that responsibility before the Board instead. We agreed with this submission. We feel it is extremely unfair to the Respondent that we gave leave to the Appellant to file a substantive bundle of documents only in the morning of the hearing. We do not find that there was any reasonable ground which allow the Board to make the discretion to admit such documents. Simply on this ground of 'late application', we dismissed the Appellant's application for admitting documents in Bundle as evidence.

34. Even if we were wrong in exercising our discretion on the reason of late application, we would still refuse the Appellant's application on the reason that the prejudicial effects of such documents would outweigh their probative values.

The Statutory Provisions relating to Profits Tax

35. 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), 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) 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 5⁶, which shall be added to the tax charged and recovered therewith.’

The Relevant Legal Principles

36. The Respondent submitted the following authorities, which illustrate the well-established legal principles relating to profits tax.

Charge of Profit Tax

⁶ The amount specified in Part 1 of Schedule 5 of the IRO is HK\$25,000.

37. 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 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

38. 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.

39. 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.

40. 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.’

41. 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.’

42. 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.’

Burden of Proof

43. As noted by Deputy Judge To in paragraph 32 of CIR v Common Empire Limited (No.2) (2007) 3 HKLRD 75 at 89-I:

‘Thus, the law is very well settled. Section 68(4) of the Inland Revenue Ordinance imposes on the taxpayer the legal or persuasive burden of proving that the assessment appealed against its excessive or incorrect. The Commissioner has no burden of proving that the assessment is correct. Hence, the Board is not bound to make any finding of fact one way or the other. If the taxpayer fails to adduce any evidence to discharge his burden, or if his evidence is disbelieved, the appeal shall be resolved on burden of proof by dismissing the appeal an upholding the assessment.’

44. The Court of Final Appeal in Kim Eng Securities (Hong Kong) Ltd v Commissioner of Inland Revenue (2007) 10 HKCFAR 213 made similar remark at paragraph 50 that ‘after all, it bears the burden of showing that the assessments are wrong’. This view was also expressed by the Court of Final Appeal in Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue (2008) 11 HKCFAR 433 at paragraphs 32, 35 and 47.

45. The Court of First Instance in Commissioner of Inland Revenue v Crown Brilliance Ltd [2016] 3 HKC 140 confirmed that the Board erred in law in relying on the taxpayer’s representatives’ representations which were unsupported by evidence in the circumstances where the taxpayer despite the invitation of the Board chose not to call any witness to give oral testimony on its behalf and be tendered for cross-examination by the Commissioner and for questioning by the Board and held that:

‘16. *Under the Ordinance, the onus of proving the assessment is excessive or incorrect lies on the taxpayer: s.68(4). Where the facts are in dispute, it is for the Board to make findings on the basis of the evidence adduced before it’.*

‘19. In the present context, I accept the submission of Mr Leung, who appeared for the Commissioner on this appeal, that a fact is not provided by its assertion in argument. It is proved by evidence, oral or documentary. The representations and oral submissions made by the tax representative, without more, do not amount to evidence. This has been the practice of the Board itself: see Board of Review Decisions Nos D7/08 at §64, D35/10 at §§12-13, D18/13 at §50 and

D28/12 at §§16-17.’

Weight of Evidence

46. The Board may ‘draw adverse inference against a taxpayer who is in the best position to provide such relevant information but has refused to do so in the witness box ... at the very least, this Board cannot attach much weight, if any, to the allegations and assertions of a taxpayer which are not tested by cross-examination. In other words, a taxpayer cannot expect this Board to act on his or her bare allegations.’ (see D8/16 (2016-17) IRBRD, vol 31, 502 at paragraph 19 citing D14/08 (2008-09) IRBRD, vol 23, 244 at paragraph 52 and 53 and D45/10 (2011-12) IRBRD, vol 26, 21 at paragraph 18 followed).

Submission of Mr Yip for the Appellant

47. Since the Board refused to admit the documents in Bundle as evidence, the only evidences which Mr Yip could rely on to make his submission are the agreed facts set out in paragraph 12 of this Decision as well as the documents in B1 Bundle and R1 Bundle.

48. Mr Yip referred the Board to page 11 to page 70 of R1 Bundle which were the audited accounts of the Appellant for the financial year from 2012/13 to year 2015/16. It is his submission that if there were any operation in Hong Kong, the Appellant should have fixed assets in Hong Kong. However, the audited accounts showed that the Appellant did not have any fixed assets in Hong Kong during the material period. Neither did the Appellant have an office in Hong Kong during the material period. What the Appellant had at that period of time in Hong Kong was a correspondence address. It is his argument that the Appellant did not have an operation in Hong Kong.

49. Mr Yip submitted that from the invoice exhibited (page 9 to page 12 of B1 Bundle), one could see that the Appellant used its City J Office as its corresponding address for the purposes of issuance of the invoice to Company C for payment. As such, it was his submission that the invoices were not issued in Hong Kong but in City J and it would support the fact that the Appellant’s operation was in Mainland.

50. Mr Yip referred the Board to page 144 of R1 Bundle which is the annual return of the Appellant filed with the Companies Registry on 23 January 2013. Mr Yip pointed out that Ms A reported her City J address as her residential address. Since she had a City J address, it was Mr Yip’s argument that Ms A could provide service in the Mainland. Mr Yip further submitted that Ms A did not use any Hong Kong address in the annual return and persistently used her City J address in the annual returns filed by the Appellant with the Companies Registry for the material period.

51. Although Mr Yip did not have evidence, he was told that whenever Ms A was in Hong Kong during the material time, she came here as a visitor only. It was his argument that Ms A did not provide any services in Hong Kong.

52. Mr Yip also referred us to the judgement of ING Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue (which was in the Bundle). The principle

enunciated by the learned judge in this case had been set out in paragraphs 38 to 41 of this Decision. This was the common ground of the Appellant and the Respondent.

53. Since the project involved the design and installation of large machine, Mr Yip submitted that the interpretation and the technical support services provided by Ms A on behalf of the Appellant should be onsite and could only be in Mainland.

54. Mr Yip referred the Board to the Company B Contract made amongst Company C, Mr D and the Appellant dated 15 March 2010 (page 3 to page 7 of B1 Bundle)('Contract') and the Supplemental Company B Contract made by the same parties and made in April 2013 ('Supplemental Contract'). Mr Yip stressed that the recital of the Contract provides that Mr D (Party B) and the Appellant (Party C) provide evaporator design, marketing development and consulting services in the Mainland. It was his submission that as the Contract specified that the services should be in the Mainland, it followed that the services provided by the Appellant to earn the service fee should be in the Mainland, not in Hong Kong. It was his submission that all the incomes of the Appellant were originated from the Mainland.

55. Mr Yip agreed that the Appellant did not have any business licence issued by the relevant authority to conduct business in the Mainland. However, he submitted that it was lawful for the staff of the Appellant went to Mainland and provided services there. Further it was his view that whether or not the Appellant had the business licence, the incomes were originated from the services rendered in the Mainland.

56. As far as he knew, Mr Yip submitted that Mr E was not involved in providing services to the customers of Company C. All work was rendered by Ms A who worked together with the designer Mr D. Such work was limited to acting as an interpreter for Mr D and the customers of Company C.

57. In relation to Mr D, Mr Yip submitted that if there was a project in Mainland, he had to perform his duties entirely and completely in Mainland.

58. Mr Yip further submitted that since the incomes were earned in Mainland, Company C withheld 10% of the income tax payable to the Appellant and paid for and on behalf of the Appellant to the tax authority in the Mainland the said 10% tax money before the balance was remitted to Hong Kong as requested by the Appellant.

Submission of Ms Yau for the Respondent

59. Save the technical submission on law and guiding principles on offshore profit claims, Ms Yau made a very brief submission on the facts of the case. It was her submission that the claim of the Appellant that it did not carry on a business in Hong Kong was negated by the facts that (a) the Appellant had 2 bank accounts in Hong Kong and Company C was requested to pay the service fee to the Appellant by remitting the same into the Appellant's Bank G account; (b) the Appellant was incorporated in Hong Kong with registered office in Hong Kong; and (c) its financial statements were audited by certified public accountants in Hong Kong.

60. Ms Yau submitted that the documents and information provided by the Appellant to the Board or to the Respondent were not sufficient to substantiate its offshore claim. It was her submission that there was no evidence on what actually were the services provided by the Appellant to earn the profits in question, nor how, where and by whom those services were rendered.

Discussion and Analysis

61. As pointed out by the guiding principles set out in the above, in order to consider the Appellant's offshore claim, we need to find out 'what the Appellant has done to earn the income or profits in question and where the Appellant has done for the same'.

What the Appellant has done to earn the profit?

62. In the fact-finding process, the Board needs to consider the documents filed and/or oral testimony called by the parties. Since neither party called any witness to testify, we have to undertake the exercise by evaluating only the documents admitted as evidence.

63. The claimed offshore profits for the 4 financial years from 2012/13 to 2015/16 amounted to HK\$14,429,750.00 (ranging from \$4.133 million in 2012/13, \$7.152 million in 2013/14, \$0.884 million in 2014/15 and \$2.258 million in 2015/16).

64. It is the Appellant's submission that such service fees were earned by Ms A (for the Appellant) solely. The services provided were limited only to as an interpreter between the designer Mr D and the customers of Company C. Mr Yip claimed that such interpretation required the special skill of Ms A as she needed to have technical knowledge about the evaporators. Mr Yip stressed that the Appellant did not provide other services to the Company C in order to earn such fees.

65. It is noted that the Appellant described the services provided in the 4 invoices issued to Company C being 'Market Service Fee' (collectively 'the Invoices'). None of them recorded that the services provided being 'Fees for interpreting or technical support'. None of the Invoices provided detailed descriptions of (a) the services provided by the Appellant; (b) the time or period in which the services were provided; (c) the calculation of the fees; and (d) identity of customers in questions etc. Although it was Mr Yip's submission that 10% of the income was withheld by Company C for payment of tax in the Mainland before the remittance to the Appellant, no such information was set out in any of the Invoices.

66. When compared the services provided to the amount of income received, it appears that the services provided were disproportionate to the fees paid by the service receiver.

67. It is the Appellant's position that it earned its income on the strength of the Contract and Supplemental Contract which provided that Company C shall pay 10% of the contract value, which includes a 5% technical service fee and 5% marketing commission to

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Mr D and the Appellant if the contract is signed with a customer introduced by Mr D or the Appellant and Mr D and the Appellant provide sales support (Clause 1.6).

68. Clause 1.7 of the Contract provided that when the value of evaporators sales contracts in a calendar year exceeds 100,000,000 RMB, the technical services fee specified in item 1.5 on the amount above 100,000,000 RMB in the same calendar year will be 3%. The market commission as specified in item 1.6 shall remain 5%.

69. In the absence of further explanation, we simply could not find there was a correlation between the Invoices and the Contract in question.

70. On the face of the Contract, Mr D and the Appellant were paid a 5% technical service fee and 5% marketing commission by Company C. It is the position of the Appellant that Mr D was the designer in question. It follows that what Mr D earned was the technical service fee and what the Appellant could earn was the marketing fee. We do not know whether it was the sole reason for the Appellant to make the description of services provided in the Invoices as 'Market Service Fee'. If it was true, it would contradict the Appellant's claim that the services provided were the interpretation provided by Ms A to Mr D and the customers of Company C.

71. The purported interpretation services generated a sum of HK\$14,429,785 over 4 consecutive financial years in question for the Appellant. On average, the 'interpretation fee' amounts to HK\$3,607,446 each year, or about HK\$300,600 each month (continuously for 4 years), or HK\$9,883.00 per day (continuously for 4 years). In the absence of other evidence to explain why it had to be so, it is incredible that Ms A could earn HK\$9,883.00 on 365-day basis continuously for 4 years purely on interpretation. The calculation was made without regard to the fact that Ms A should not have rendered services each and every day for 4 years. For example, she had 20 days in Hong Kong. She might stay outside the Mainland (other than Hong Kong) during the material period. It follows that the daily income earned by Ms A should be more than the sum of HK\$9,883. As admitted by Mr Yip, Mr D could return to US if he had nothing to do in Mainland. If we take this fact into account, the daily income earned by Ms A was far more than the average daily rate of HK\$9,883.

72. On the face of the documents, we were not certain what services were exactly provided by the Appellant to earn the amount of HK\$14,429,750.00 during the material period.

Where did the Appellant perform the service to earn the profit in question?

73. The Appellant claimed that since the services provided by Ms A were limited to interpretation (including technical interpretation), as such the provision of the interpretation needed to be onsite, ie the services should be provided in the Mainland, as provided in the Contract.

74. Since we are not certain on what exactly the Appellant did to earn the income, it follows that we are not certain that the services were totally provided or rendered in the Mainland.

75. For discussion purpose, even if we assume that the services provided were solely interpretation, it is not necessarily that they should be provided in the Mainland. We should bear in mind that Ms A had 20 days stayed in Hong Kong during the material period, it was still possible that the Appellant provided the interpretation services while she was in Hong Kong through computer or zoom meeting or telephone.

76. In the absence of explanation from Ms A, we simply could not draw the conclusion as to the place of providing services in order to earn the incomes in question.

77. The contents of the Contract and the Invoice could suggest that the services provided by the Appellant were marketing service. To us, the ‘marketing service’ had the meaning of concluding deals between Company C and the customers through the introduction of the Appellant. Although Ms A provided the services of interpretation, there remains the possibility that Mr E being a director of the Appellant could provide the marketing services to Company C in Hong Kong.

78. In the absence of explanation provided by the Appellant to remove the doubts arising from the suggestion, we could not be certain on the place in which the Appellant provided the services to earn the incomes or profits in question.

Whether the Appellant had any business activities in Hong Kong?

79. The principal activities reported in the Appellant’s audited accounts for the relevant financial years were ‘provision for evaporator design, marketing development and consulting services in Mainland during the year’. One could argue that ‘interpretation services’ was part of the ‘consulting services’. If ‘interpretation’ was the main business, the Appellant should add in ‘interpretation services’ as one of its principal activities in its audit reports issued in the subsequent years once it found that its services provided were limited to ‘interpretation’ and its claimed income of several million a year was from ‘interpretation’. In the absence of express wording of ‘interpretation’ as its principal activity or one of principal activities in its audited financial statements, we feel it is more probable that the Appellant’s business was more ‘marketing development of evaporator’ than ‘interpretation’.

80. Mr Yip submitted that as the Appellant did not have fixed assets and had no office in Hong Kong in the material period, the Appellant could not provide services in Hong Kong. While we agree that there is some persuasive force in this submission, this argument should be viewed against the other facts of the case. We should not ignore the fact that it is still probable that the Appellant could provide services in Hong Kong, no matter it was ‘marketing development of evaporator’ or ‘interpretation’ because they could provide the service by phone, computer or by zoom meeting in Hong Kong. The Board needed further evidence as to the operation of the Appellant before it could come to any conclusion that the Appellant could not provide services in Hong Kong simply because it did not have fixed assets or an office here.

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81. The Appellant maintained two banking accounts in Hong Kong, one with Bank G and the other with Bank H. We note that the Appellant did not disclose any bank statements of its account with Bank H and Bank G. The Board has denied the admission of the 2 pages of bank statements of its account with Bank G selected by the Appellant.

82. The fact of maintaining two bank accounts in Hong Kong on the part of the Appellant suggests that the Appellant might have business activity in Hong Kong. If it did not, it is legitimate for the Board to know why it needed to maintain 2 bank accounts in Hong Kong.

83. In order that one could conduct business in Mainland, he or it should apply for and be granted a business licence issued by the relevant Mainland authority. It is not disputed that the Appellant did not have such a business licence. On the face of it, the Appellant could not possibly conduct any business in Mainland. It therefore created doubt as to the claim that all services were rendered by the Appellant in Mainland for the incomes during the material period.

84. Given the aforesaid doubts or possibilities, it is desirable that someone should be called to give evidence to clarify them. Unfortunately, the Appellant decided not to call any witness. The Board does not have the benefit of evaluating the documents in the light of the oral evidence of its witness(es) called by the Appellant.

85. We could not criticize the Appellant for not calling its witnesses to clarify the queries because the Appellant had the sole discretion to decide whether or not to call witnesses to testify on its behalf.

86. If there is any suggestion that the Appellant could not call Ms A or Mr E to testify on the ground that they were outside Hong Kong and due to Covid-19 they were deterred from coming to Hong Kong to give evidence, we do not feel such suggestion is a valid reason. They could, if they desired, give oral evidence by zoom meeting.

87. Given the aforesaid doubts and queries, we could not resolve that the Appellant's profits in question were wholly derived outside Hong Kong and should not be chargeable to Hong Kong Profits Tax.

88. Accordingly, the Board has to say that the Appellant has failed to discharge its burden that the profits in question were wholly derived outside Hong Kong. It is our conclusion that the Appellant has failed to discharge, under section 68(4) of the Ordinance, its onus of proving that the Profits Tax assessments for the years of assessment 2012/13 to 2015/16 were excessive or incorrect.

Disposition

89. Accordingly, the appeal is dismissed and the Profits Tax Assessments are hereby confirmed.

Costs

90. 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.

91. As discussed and analyzed in the above, the evidences submitted by the Appellant to support its claim that the profits earned in the assessment years of 2012/13 to 2015/16 were offshore were flimsy and vague. As an example, it is hard for any reasonable man to believe that the service of interpretation could generate an income of more than HK\$14 million over 4 years. It is just incredible in the absence of other evidence to explain why it had to be so.

92. Some of the submissions made by Mr Yip were bare or mere allegations without support of evidences. Further, the documentary evidences submitted by the Appellant were scarce and sometimes incomplete.

93. The Appellant chose not to comply with the directions given by the Board in relation to filing and service of witness statement(s) and documents. The Appellant did not show its respect to the directions made by the Board.

94. The aggregate tax payable on the subject profits tax assessments for the 4 financial years in question amounts to HK\$2,330,907.00. 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.

95. The dilatoriness on the part of the Appellant to respond to the Respondent's request for documents and the submission of the documents at the last minute to the Board for consideration would incur unnecessary public fund to deal with.

96. In the circumstances, the Board feels it right to order and herein orders the Appellant to pay a sum of HK\$15,000 as costs of the Board which shall be added to the tax charged and recovered therewith pursuant to section 68(9) of the Ordinance.