Case No. D14/15

Profits tax – source – sections 2, 14 and 68(4) of the Inland Revenue Ordinance

Panel: Elaine Liu Yuk Ling (chairman), Simon Leung Wing Yin and Mak Siu Cheung Bernard Jaun.

Dates of hearing: 30 March and 1 April 2015.
Date of decision: 12 October 2015.

The Taxpayer is a company incorporated in Hong Kong to operate ores trading business in the Mainland. Its objection to the Profits Tax Assessments for the years of assessment 2000/01 to 2003/04 and Additional Profits Tax Assessments for the years of assessment 2004/05 to 2005/06 raised on the ground that part of its trading profits earned in those years were derived outside Hong Kong and should be chargeable to Profits Tax was rejected. The Taxpayer, relying on sample transactions, appealed and contended that the entirety of profits in issue was offshore profits derived outside Hong Kong.

Held:

1. In determining the source of trading profits of the taxpayer the focus should be the bringing together of the sellers and the buyers without being distracted by antecedents and incidental matters. A number of factors should be considered. These include the respective places of negotiation, solicitation and procurement of the supply contracts and sale contracts, the manner of shipment, the arrangement for the financing and how the payment was effected. The Board found on evidence that the financial arrangements for paying the suppliers were all done in Hong Kong and some of the purchase and supply contracts were signed in Hong Kong. The Board held that the Taxpayer had failed to prove that the profits in issue arose in or were derived from outside Hong Kong. Accordingly, the appeal was dismissed and all the assessments appealed against were confirmed.

Appeal dismissed.

Cases referred to:

Commissioner of Inland Revenue v Hang Seng Bank Limited [1991] 1 AC 306

Orion Caribbean Limited (in voluntary liquidation) v Commissioner of Inland Revenue [1997] HKLRD 924
Kwong Mile Services Limited v Commissioner of Inland Revenue (2004) 7 HKCFAR 275
Commissioner of Inland Revenue v HK-TVB International Limited [1992] 2 AC 397
ING Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue (2007) 10 HKCFAR 417
Commissioner of Inland Revenue v Datatronic Ltd [2009] 4 HKLRD 675
Exxon Chemical International Supply SA v Commissioner of Inland Revenue (1989) 3 HKTC 57
Commissioner of Inland Revenue v Euro Tech (Far East) Ltd 4 HKTC 30
D1/12, (2012-13) IRBRD, vol 27, 131
Commissioner of Inland Revenue v Magna Industrial Co Ltd [1997] HKLRD 173

Wu Anthony, Counsel, instructed by GDT CPA Limited for the appellant.
Mike Lui, Counsel, instructed by Department of Justice for the Commissioner of Inland Revenue.

Decision:

Introduction

1. The Appellant is a company incorporated in Hong Kong in August 1995.

2. By a determination dated 8 March 2013 ('Determination'), the Deputy Commissioner of Inland Revenue ('Deputy CIR') rejected the Appellant's objection to the Profits Tax Assessments for the years of assessment 2000/01 to 2003/04 and Additional Profits Tax Assessments for the years of assessment 2004/05 to 2005/06 on the ground that part of its trading profits earned in those years were derived outside Hong Kong and should not be chargeable to Profits Tax. The Deputy CIR confirmed:

(1) Profits Tax Assessment for the year of assessment 2000/01 under Charge Number X-XXXXXXX-XX-X, dated 30 March 2007, showing Net Assessable Profits of $9,476,115 with Tax Payable thereon of $1,516,178;

(2) Profits Tax Assessment for the year of assessment 2001/02 under Charge Number X-XXXXXXX-XX-X, dated 25 March 2008, showing Assessable Profits of $7,571,301 with Tax Payable thereon of $1,211,408;

(3) Profits Tax Assessment for the year of assessment 2002/03 under Charge Number X-XXXXXXX-XX-X, dated 21 January 2009, showing Assessable Profits of $9,744,745 with Tax Payable thereon of $1,559,159;

(4) Profits Tax Assessment for the year of assessment 2003/04 under Charge Number X-XXXXXXX-XX-X, dated 21 January 2009, showing Assessable Profits of $41,810,834 with Tax Payable thereon of $7,316,895;

(5) Additional Profits Tax Assessment for the year of assessment 2004/05 under Charge Number X-XXXXXXX-XX-X, dated 21 January 2009, showing Additional Assessable Profits of $20,922,479 with Additional Tax Payable thereon of $3,661,434; and

(6) Additional Profits Tax Assessment for the year of assessment 2005/06 under Charge Number X-XXXXXXX-XX-X, dated 23 January 2009, showing Additional Assessable Profits of $924,158 with Additional Tax Payable thereon of $161,728.

3. The Appellant appealed against the Determination. The Statement of the Grounds of Appeal filed by the Appellant did not state its grounds of appeal in clear terms. Counsel for the Appellant confirmed at the hearing that the only issue before the Board is whether the trading profits in question were derived outside Hong Kong.

The Legal Principles

Relevant provisions of the Ordinance

4. The charging provisions for profits tax is Section 14, 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.*’

5. ‘Profits arising in or derived from Hong Kong’ was defined in Section 2 of the Ordinance 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;*’

The Relevant Authorities

6. The Privy Council in Commissioner of Inland Revenue v Hang Seng Bank Limited [1991] 1 AC 306 laid down at page 318E to F three conditions for a charge to tax as follows:

> ' *(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.*'

7. The issue in this appeal was on the third condition, namely whether the profits in issue arose in or were derived from Hong Kong. By virtue of section 2, profits arose from business transacted in Hong Kong through an agent are included.

Source

8. The question of source was recognized by a number of authorities as a practical hard matter of fact depending on the nature of the transaction. No precise rule or single test can be employed. (Commissioner of Inland Revenue v Hang Seng Bank Limited [1991] 1 AC 306; Orion Caribbean Limited (in voluntary liquidation) v Commissioner of Inland Revenue [1997] HKLRD 924 at page 931; Kwong Mile Services Limited v Commissioner of Inland Revenue (2004) 7 HKCFAR 275 at paragraph 7)

9. The broad guiding principle is: 'one looks to see what the taxpayer has done to earn the profit in question and *where* he has done it' (emphasis added). (Commissioner of Inland Revenue v HK-TVB International Limited [1992] 2 AC 397 at page 407C, applying the Hang Seng Bank case, supra)

10. To determine whether certain profits are onshore or offshore, the focus must be on the nature of the transactions which gave rise to such profits. The focus shall be on the effective causes without being distracted by antecedent or incidental matters. In ING Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue (2007) 10 HKCFAR 417, Riberio PJ held that:

> ' *38. In Kwong Mile Services Ltd v Commissioner of Inland Revenue, applying the abovementioned authorities, this Court noted that 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 section 14'

11. Lord Millet NPJ held in ING Baring as follows:

'*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.*'

'*131. It is well established in this as in a number of other jurisdictions that the source of profits is a hard practical matter of fact to be judged as a practical reality. It is, in other words, not a technical matter but a commercial one.*'

'*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.*'

'*147. In summary (i) the place where the taxpayer's profits arise is not necessarily the place where he carries on business; (ii) where the taxpayer earns a commission for rendering a service to a client, his profit is earned in the place where the service is rendered not where the contract for commission is entered into; (iii) the transactions must be looked at separately and the profits of each transaction considered on their own; and (iv) where the taxpayer employs others to act for him in carrying out a transaction for a client, his profit is earned in the place where they carry out his instructions whether they do so as agents or principals.*'

12. It is the profit-making transaction that one has to focus and not to be confused by technical assistance. (Commissioner of Inland Revenue v Datatronic Ltd [2009] 4 HKLRD 675, per Tang VP)

Profit producing transaction of a trading company

13. In Exxon Chemical International Supply SA v Commissioner of Inland Revenue (1989) 3 HKTC 57, the acts of obtaining the purchaser's order and the placing of the order with the seller were held to be the foundations of the transaction and that it was the differential between the selling price and the buying price which generated the profit.

14. In Commissioner of Inland Revenue v Euro Tech (Far East) Ltd 4 HKTC 30, Barnett J held that the operation of the taxpayer in that case, like many other trading companies, was the bringing together of the complementary needs of sellers and purchasers.

15. In Decision D1/12, (2012-13) IRBRD, vol 27, 131, the profit producing transaction of a trader was held to be the bringing together of the complementary needs of its suppliers and customers:

> ' *As a trader, what the Appellant did was to bring together the complementary needs of its suppliers and customers. It earned no profit unless and until it had entered into matching contracts with a supplier, buying at a lower price and with a customer, selling at a higher price. The profit producing transactions were to bring together the supplier and the customer by entering into matching contracts with a supplier and a customer. The Appellant would earn the mark-up as profit.*' (at paragraph 88)

16. In determining the source of profits of trading companies,

> ' *one looks to see what the taxpayer has done to earn the profits and where he has done it. Obviously the question where the goods were bought and sold is important. But there are other questions: For example: How were the goods procured and stored? How were the sales solicited? How were the orders processed? How were the goods shipped? How was the financing arranged? How was the payment effected?*' (Commissioner of Inland Revenue v Magna Industrial Co Ltd [1997] HKLRD 173 at page 176F to G)

Company carrying on business in Hong Kong can earn profits arising outside Hong Kong

17. The Privy Council in Commissioner of Inland Revenue v HK-TVB International Limited [1992] 2 AC 397 accepted that a company carrying on business in Hong Kong can earn profits which was derived from outside Hong Kong:

> ' *It is clear from the Hang Seng Bank case [1991] 1 AC 306 that in appropriate circumstances a company carrying on business in Hong Kong can earn profits which do not arise in or derive from the colony, notwithstanding the fact that those profits are not attributable to an independent overseas branch.*' (at page 410)

18. The Privy Council has also stated at page 409G that:

> ' *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.*'

19. The above statement was accepted by the Court of Appeal in Hong Kong as a matter of common sense. (Commissioner of Inland Revenue v Magna Industrial Co Ltd [1997] HKLRD 173 at 179E to F)

Onus of proof

20. The onus is on the Appellant to prove that the assessment appealed against is excessive or incorrect. (Section 68(4))

21. Before we turn to the evidence and the analysis, we echo what the Board has said in Decision D1/12, (2012-13) IRBRD, vol 27, 131 as follows:

> ' *83. At the outset of our decision on source, we remind ourselves that, as the Appellant bears the burden of proof, it is not in a position to benefit from sparsity in evidence.*'

No agreed statement of facts

22. There was no agreed statement of facts from the parties.

23. The Respondent expressed its criticism on the lack of documentary evidence produced by the Appellant to substantiate in particular operations in relation to how purchases from overseas suppliers and sales to customers in the Mainland China were negotiated. Notwithstanding this, the Respondent was prepared to argue this appeal on the basis of the 'facts' identified in the Determination as well as the evidence in the Appellant's witness statements, and invited the Board to approach the Appellant's evidence with circumspection.

Parameters of the Appellant's case

24. The Appellant's case was that the entirety of profits in issue was offshore profits. The Appellant was not contending that the profits were of a mixed source, thus there was no issue of apportionment.

25. In this appeal, the Appellant identified two transactions as sample transactions ('Relevant Transactions'), namely (1) sales invoice no. 0034F ('Transaction 1') and (2) sales invoices nos. 03084, 03085-A, 03085-B and 03085-C ('Transaction 2').

26. We pointed out here that the Relevant Transactions identified as sample transactions for the purpose of this appeal were different from the sample transactions identified by the Appellant in its objection to the assessment. At the stage of assessment and the Appellant's objection, the Appellant adopted Transaction 1 and another transaction relating to sale invoices nos. 04014F, 04015F, 04016F and 04017F ('Sales 04014-7F') as sample transactions. In this appeal, the Appellant abandoned Sales 04014-7F and, instead, relied on Transaction 2 as one of the sample transactions. The Respondent has no objection.

The Appellant's evidence

27. The Appellant has called 4 witnesses, namely Mr A, Ms B, Mr C and Mr D. They all adopted their respective witness statements as the evidence in chief.

28. Mr A and his wife Ms B were the directors of the Appellant from 1995 to 2010. Mr C was employed by the Appellant during the period of 1 April 2000 to 30 September 2002. Mr D was the employee of the Appellant between July 2002 and July 2006.

Mr A's evidence

29. Mr A and his wife, Ms B, established a shipping company named Company E in 1987 in Hong Kong, carrying on vessel chartering business. Company E has an office in Hong Kong. Ms B assisted Mr A in handling the administrative and financial matters of Company E in the Hong Kong office.

30. In about 1995, Mr A and a Ms F who is a Mainland citizen, agreed to cooperate and set up a company to operate ores trading business in the Mainland. As the procedures and approval process for establishing a foreign invested company in Mainland China were extremely complicated and time consuming, and that foreign exchange control in Mainland China would cause difficulties in obtaining L/C facilities, they decided to use a company established in Hong Kong to save time and costs. The Appellant was established for this purpose.

31. After one year of its establishment which was in about 1996, Ms F withdrew from the business of the Appellant. Mr A operated the ores trading business of the Appellant by himself in earlier years, and Ms B assisted him with the administrative and financial matters.

32. The Appellant was mainly selling iron ores, manganese ores and ferro manganese in the relevant years of assessment from 2000/01 to 2005/06.

33. In his witness statement, Mr A described his works as follows: he travelled frequently to ports, mining companies and steel mills in the Mainland China to establish business relationship. He also attended iron alloy industry conferences in the Mainland China to explore business relationship. He travelled to mining companies in Country G and Continent H for site visit of ores mines.

34. Mr A explained the importance of the testing of the sample products. He said that steel mills would only consider placing order if the result of testing sample ores confirmed that the product quality and steelmaking by the blast furnace would not be affected. To develop business, Mr A had to bring the samples of ores to steel mills to promote, persuade and communicate with their technical personnel for a long period of time and to let them test the sample ores to adjust the ores prescription for steel making.

35. Mr A had to visit the steel mills bringing along the information of ores and samples to communicate and establish good relationship with factory directors, ores procurement and technical personnel. So when the steel mills needed to purchase ores, they would give priority to place orders with the Appellant.

36. Mr A said that the market for the ores in the relevant years of assessment were demand driven. All negotiation of the contracts were done in face to face meetings outside Hong Kong where the steel mills and mining companies were located. He also said that there were not much to agree on except the major items such as the price, quantity and shipping details.

The Relevant Transactions

37. According to the Appellant, the two main suppliers in the Relevant Transactions were Company J for manganese ores, and Company K for iron ores.

38. Mr A said that all the negotiation and signing of the purchase and sale contracts were done overseas at face-to-face meetings. The contracts would be signed subsequently, and not necessarily on the same date of the negotiation. In his witness statements, he stated that '[d]uring the entire negotiation process of contracts, I only needed to write down specifications of ores, quantity, unit price, shipment deadline and other simple information. It was not necessary to record the negotiation details for each meeting. I usually did not keep the written notes for trading orders after the contracts were signed.'

39. Mr A said that the price of iron ores was mainly controlled by a few major overseas mining companies, including Company L. Company L would regularly announce the benchmark price for supply of iron ores to Mainland China in the coming year ('Benchmark Price'). The major suppliers of iron ores to the Appellant including Company L and Company K supplied iron ores to the Appellant based on the Benchmark Price. Mr A said that there was not much room for him to negotiate the price with the mining companies. Annual supply contract with Company J was entered into. The Appellant then sold the iron ores to ultimate purchasers.

40. According to Mr A, there was no Benchmark Price for the trading of manganese ores and ferro manganese. The Appellant kept frequent contact with customers or attended iron alloy industry conference in Mainland China to find out the customers' intended purchase price of manganese ores as basis to negotiate purchase price with

suppliers. The supply contract with Company K was only signed after the Appellant identified the ultimate purchaser.

41. The contracts were, according to Mr A, signed by him, or when he was not available, by Ms B. Mr A contended that he signed the contracts outside Hong Kong. It was accepted by the Appellant that Ms B signed the contracts in Hong Kong.

42. The arrangement for the payments and issuance of Letters of Credit were done in Hong Kong by Ms B or staff of Company E. The Letters of Credit were either issued in the name of the Appellant or Company E. The sale proceeds were received by the Appellant in Hong Kong. Documents including the purchase invoices, on board bills of lading, certificates of quality, certificates of weight and certificates of origin, issued by the supplier were received by the Appellant in Hong Kong. The sales invoices and other shipping documents were provided to the customers by the Appellant in Hong Kong.

43. Company M, which was managed by Mr A's brother Mr N has provided the office space in City P for the use of the Appellant. Company M's staff assisted in, for example, handling customs declaration, transportation of ores and preparation of the written contract.

44. The Appellant produced for the purpose of this appeal purchase contracts, sale contracts, shipping documents and letters of credit in respect of the Relevant Transactions.

Mr C's evidence

45. Mr C was employed by the Appellant during April 2000 to September 2002 as Position Q. He stated in his witness statement that his work base was in the Mainland China, and the Appellant's sales of ores in the Mainland China were handled by him. He had the authority to conclude the contracts without seeking approval from Mr A except for special circumstances. The special circumstances, according to him, included 'deals without profits or in which the customer requested to make payment only after the ores had been received.' For such cases, he would call Mr A to report the details and seek his instructions or approval for such special circumstances. If he could not reach Mr A by the telephone, he would call Ms B in Hong Kong who would pass the message to Mr A.

46. Mr C stated in the witness statement that he 'did not prepare or keep any written records of the negotiation'.

47. Mr C also stated in his witness statement that Mr A also assigned Mr R to station in the Mainland China to assist in the promotion of the Appellant's business expansion of customer base and maintenance of good business relationship with customers.

48. He provided his residential address in City S as contact address for the Appellant. He used the office space and facilities of Company M in City P.

49. The contracts signed by Mr C were posted to the Appellant's Hong Kong office for the settlement of trade receipts and payments, and for records keeping.

Mr D's evidence

50. Mr D was employed by the Appellant from July 2002 to July 2006 as Position T. According to him, he mainly worked in the office of Company M. Company M's staff also handled import custom declaration, transportation of the ores for the Appellant. The description of his works for the Appellant was by and large similar to the description of Mr C's works in the Appellant except that Mr D passed all the contracts to Mr A or Ms B for signature.

Ms B

51. Ms B confirmed that she mainly handled financial matters of the Appellant in Hong Kong, in particular the signing of banking documents and cheques. She had signed some contracts relating to the ores trading business due to urgency and unavailability of Mr A, however, she did not participate in the negotiation of the contract terms.

Company E

52. Mr A and Ms B were the directors of Company E during the relevant years of assessment, namely 2000/01 to 2005/06. Mr A accepted in cross-examination that in the relevant years of assessment Company E terminated its own vessel chartering business, and its main function was to provide administrative and financial support to its related companies, including the Appellant.

53. According to profits tax returns filed by Company E in the relevant years, the major income of Company E was from the Appellant in the form of management fee income, loan interest income and handling income. Company E also employed about 20 staffs in Hong Kong.

54. According to Mr A, employees of Company E assisted in the business of the Appellant. These employees included Mr U, Mr V and Mr R. Mr A said their works in relation to the Appellant were all done overseas.

Company M

55. According to Mr A, Company M is a wholly foreign-owned enterprise established in City P in 1997 and were managed by his brother, Mr N, who was also the legal representative of Company M in the Mainland China. Mr N was also employed by Company E and was paid salaries every year.

56. The Appellant's case was that Company M provided office space and facilities in City P for the Appellant. Company M's staff handled the ores trading business of the

Appellant, including preparing sale contracts, custom declaration and transportation of the ores.

The Respondent's Case

57. The Respondent's main criticism against the Appellant was the lack of documentation to substantiate its contentions, in particular, on matters relating to how purchases from overseas suppliers and sales to customers in Mainland China were negotiated. The Respondent contended that it was inherently improbable and too fanciful to be credible that there was no record of negotiation at all for a multi-million dollars business conducted by the Appellant.

58. In any event, the Appellant ought to have known in late 2002 that documents evidencing various matters concerning the Appellant's trading business were required for the purpose of determining the nature of the offshore profit claimed by the Appellant. The Appellant would only have itself to blame for being unable to adduce the relevant documentation to discharge its onus of proof.

59. The Respondent attacked the Appellant's claim that Company M had rendered services and provided office space to the Appellant in City P for being devoid of credible evidential basis.

60. There is evidence showing some of the profit-generating operations must have taken place in Hong Kong.

The Board's Decision and Findings

61. The business of the Appellant during the relevant years of assessment was the trading of iron ores and manganese ores. The profits earned by the Appellant were the differences between the buying price from the suppliers and the marked-up price for sale to the customers, which were earned by bringing together the complementary needs of its suppliers and customers. (Exxon case; Euro-Tech case, D1/12 case)

62. The Appellant's case was that the entirety of the profits in issue was derived outside Hong Kong. There was, thus, no issue of mixed source or apportionment.

63. In determining the source of trading profits of the Appellant, the focus should be the bringing together of the sellers and the buyers without being distracted by antecedents and incidental matters. A number of factors should be considered. These include the respective places of negotiation, solicitation and procurement of the supply contracts and sale contracts, the manner of shipment, the arrangement for the financing and how the payment was effected. This approach was agreed by the Appellant and the Respondent.

Arrangement of Finances and Payment

64. This is straight-forward and without disagreement. It was the Appellant's own evidence that:

(1) all the payments for the trading of ores were effected in Hong Kong; and

(2) the financing arrangements and the applications for the letters of credit were done in Hong Kong by Company E or the Appellant.

65. The banking documents produced by the Appellant evidenced that the arrangement for financing were done in Hong Kong.

66. Hong Kong was deliberately chosen as the place of incorporation of the Appellant. One of the key reasons for choosing Hong Kong as the place of incorporation of the Appellant, as Mr A himself said, was to enable the issuance of letters of credit facilities for the goods and avoid any difficulties that would be caused by foreign exchange control in Mainland China. Mr A agreed that the financial arrangements by Company E or the Appellant in Hong Kong was a crucial part of the trading business. Without payment to or letters of credit issued in favour of the suppliers, the Appellant could not secure the goods for sale to customers. This ability to pay the supplier would, obviously, be important in a demand driven market. This crucial part of the operation was all done in Hong Kong.

Negotiations and signing of the purchase contracts and the sale contracts

67. The documents provided by the Appellant in regard to the Relevant Transactions (including purchase contracts, sales contracts, letters of credit, invoices, banking and shipping documents) did not shed any light on how and where the negotiation of the contracts were done, how and where the contracts were procured and how and where the Appellant brought together the complementary needs of its suppliers and customers.

68. On all these issues, the Appellant relied on the oral evidence of the witnesses.

69. We found that Mr A was evasive. One obvious example of his evasiveness was his answers to the questions on the payment of commission by the Appellant to Company M:

(1) When Mr A was asked in cross examination why Company M was not paid commission for the years of assessment in 2001/02, 2002/03 and 2005/06, he said for the first time that it was because Company M might have got some other income from helping the Appellant dealing with the trading of magnesium.

(2) When Mr A was asked why this was not mentioned in the witness statements, he said that he did not really have a clear recollection.

(3) When Mr A was asked whether the decision not to pay Company M any commission was his decision or the suggestion of the auditors. Mr A's answer was 'On this one – Okay. Well, because on this one I did not know for sure. Because he was my brother after all, okay, so when to give money, when not to give money, well, I can talk with my brother, and if the money was given, the money was given because we are kin.'

(4) Mr A further said that 'on whether we give the commission or not then it depends on the needs of the businesses. When both sides felt that there was such a need then there would be payment. But for those on which there were contracts already, then those we would pay out. Because we are brothers after all, you know, so if there is anything we need to check it over then that can be done. Unlike what those businesses carried out with a strange company where everything has to be done in a conscientious and serious manner. So there are things that we're clear, there are things that we're not clear and in my impression some of them may be unclear. This is what I want to tell you.'

70. Mr A emphasized that there was not much room for negotiation of the contracts and hence there was no need for written records of the negotiation. We do not accept this evidence of Mr A.

(1) In the case of manganese ores, there was no Benchmark Price. According to Mr A, the Appellant 'has to keep frequent contact with the customers or attend iron alloy industry conferences in Mainland China to find out the customer's intended purchase price as basis to negotiate with suppliers'. It was just common sense that some kind of records of the intended purchase prices from different buyers at different time, in difference places, for different quality of ores, would be required for future analysis and matching of the needs with those of the suppliers.

(2) In the case where the negotiation or frequent contacts with customers were done by Mr C or Mr D, one would expect there must be some kind of records for reporting to Mr A, as well as for Mr A and Ms B to verify the terms when they signed the contracts subsequently.

(3) As regards the case of iron ores where there was a Benchmark Price, there ought to have plenty of rooms for negotiation with different customers in a demand driven market and there ought to have some records.

(4) The Appellant was conducting multi-million dollars business transactions and assuming liability in purchasing goods costing multi-million dollars. Many of the negotiations were done by employees

like Mr C and Mr D, who had to report back to Mr A or Ms B. It is inherently improbable that there was not a single piece of document on or relate to the negotiation.

(5) In any event, the Appellant ought to know that documents evidencing the negotiation are required by the Respondent at least since late 2002.

(6) Even if the Appellant had indeed mislaid or threw away the documents, as the Appellant had once suggested, the Appellant has the burden of proof and should not be benefited from the sparsity in evidence.

71. Whether all the negotiations were done in face-to-face meetings overseas is a question of fact. According to Mr A, there were only a few items to agree on. The contracts with suppliers were standard and could not be changed. If that was the case, there was no reason why they did not insert the agreed items in the standard contract and sign it on the spot after the main terms were agreed. In a demand driven market, it would only be in the interest of the Appellant to secure the supply contract immediately by signing the contracts after the terms were agreed. There was no good reason that it chose to sign the contracts subsequently.

72. Mr A seemed to suggest that the purchase and supply contracts for the trading of ores were signed by him outside Hong Kong. This was contradicted by at least one purchase contract between the Appellant and Company K dated 10 January 2005, a date on which Mr A was in Hong Kong[1].

73. Mr C's evidence suggested that he signed the contracts in the Mainland China. We note that some of the contracts he produced was either unsigned or bear only the Appellant's chop without signature.

74. Ms B confirmed that she signed the contracts in Hong Kong since Mr A was not available and the signing of the contracts was urgent.

75. We found that some negotiations of the contracts were probably conducted outside Hong Kong, and some of the contracts might have been signed outside Hong Kong. However, this was only part of the picture. There are clear evidence that some of the purchase and supply contracts were signed in Hong Kong. The Appellant has not discharged its onus to prove that all the negotiations of the contracts were conducted outside Hong Kong.

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[1] The Statement of Travel Records issued by the Immigration Department showed that Mr A was in Hong Kong during 1 January 2005 to 15 January 2005.

Company E and the Hong Kong office

76. During the years of assessment, Company E has terminated its own chartering business. The major income of Company E was the management fee income received from the Appellant.

77. Company E was the financing centre of the Appellant. It performed a pivotal role in the trading business of the Appellant. When the Appellant's own letters of credit limit was not sufficient to cover the amount of the Appellant's purchase, Company E applied the letters of credit in favour of the Appellant's supplier.

78. Company E provided the office space and facilities for the Appellant's operation in Hong Kong. At least some of the employees of Company E assisted in the handling of the trading business of the Appellant. The Appellant has not satisfactorily proved that these employees only provided their services to the Appellant outside Hong Kong.

Conclusion

79. Having considered all the evidence, we hold that the Appellant failed to prove that the profits in issue arose in or were derived from outside Hong Kong. Accordingly, the appeal is dismissed and all the assessments appealed against are confirmed.

Hong Kong Inland Revenue Board of Review Decisions
(2016-17) Volume 31 (Main Volume)

Case No. D14/15

Date of Decision: 12 October 2015
Date of Corrigendum: 13 January 2017

CORRIGENDUM

At page 44, "should be chargeable to Profits Tax" should read "should not be chargeable to Profits Tax".

Clerk to the Board of Review
(Miss Christine YEUNG)