

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. BR 20/75

*Board of Review :*

L. J. D'Almada Remedios, *Chairman*, W. L. Chan, W. T. Grimsdale & G. H. P. Pritchard,  
*Members.*

**27th July 1976.**

Profits tax—interest earned on credit extended to buyer of goods abroad—interest paid by bill of exchange accepted outside Hong Kong—whether interest derived from the Colony—Inland Revenue Ordinance, section 15(1)(f).

The taxpayer, a manufacturer and exporter, sold its goods to certain foreign buyers and also acted as their buying agents. In an agreement between the parties the buyers were given 180 days to pay for the goods and in return for the credit extended interest was to be charged by the taxpayer. Payment was effected by two separate bills of exchange in U.S. dollars, drawn by the taxpayer on the buyers, one for the price of the goods and the other for the interest payable, both bills were accepted outside Hong Kong. On being assessed for profits tax on the interest payments under section 15(1)(f) the taxpayer appealed on the ground that the indebtedness in respect of interest charges as distinct from the sales arose outside the Colony.

**Decision:** Appeal dismissed. Assessment confirmed.

Henry Litton, Q.C. for the appellant.

Chan Kam-cheong for the Commissioner of Inland Revenue.

*Reasons :*

The facts as set out by the Commissioner are agreed. They can be summarized as follows : M. is a company carrying on business in Hong Kong. It manufactures and exports garments. R. N. Company Inc., and M. P. Company (hereafter referred to as “the buyers”) are companies in the United States of America who purchase garments from M. M. derives merchandising profits on sales of garments to them. It also earns commission income as buying agents for M. P. Company. Prior to April 1970, these buyers settled the cost of their purchases from M. by means of sight drafts. As the volume of turnover increased the buyers found it difficult to raise funds for immediate payment; so an agreement was arrived for payment by the buyers 180 days after presentment of a bill of exchange drawn by M. on the buyers, delivery against acceptance. In return, M. would be entitled to interest payments by the buyers on the credit so extended.

The question that arises in this appeal is whether M. is liable to profits tax on the interest payments received by M. from the buyers having regard to section 15(1)(f) of the Inland Revenue Ordinance. It is clear that “interest” received by a person in Hong Kong is

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only chargeable to tax (whether as Interest Tax under section 28 or as Profits Tax by virtue of section 15(1)(f) ) where such interest was derived from the Colony. The case for M. is that the interest received from the buyers for the provision of credit by M. was not derived from the Colony.

It is not denied that the commissions and merchandising profits earned by M. are assessable to Profits Tax. It follows, therefore, that if a different treatment is to be attributed to the interests earned it would necessitate our examining what those aspects are and to what extent it can be said that different considerations apply for the purpose of concluding that the interests earned were not derived from the Colony.

To continue with the narrative we would add that the garments are invoiced by M. to the buyers for payment in U.S. dollars on 180 days, D/A terms. On shipment of the merchandise to the buyers, M. would draw a bill of exchange on the buyers for the price, payment deferred for 180 days and for delivery against acceptance of the bill. The interest charged is not included in the bill drawn for the price of the goods. Simultaneously, or even before such a bill is drawn for the sale of the garments, a separate bill of exchange is drawn by M. on the buyers for a specified sum of interest payable in U.S. dollars. For this reason it is contended on behalf of M. that as interest charges were billed to and settled separately from the actual sales transaction coupled with the fact that such bills of exchange were accepted by the buyers outside Hong Kong, the indebtedness in respect of interest charges as distinct from the sales were not derived in the Colony.

We are unable to agree with the conclusion urged upon us on behalf of M. For Profits Tax purposes, we do not see how the interest element stands on a different footing from the merchandising profits and commissions earned. It is not the drawing of a bill of exchange that creates the liability for payment of interest. It is the agreement between M. and the buyers that in transactions for the sale of garments interest is payable. In the same way, it is not the drawing of a bill of exchange that creates the liability for payment of price for garments supplied; it is the agreement between the parties. Leaving aside hair-splitting subtleties of argument, we think that, on the facts, a practical business man would regard the drawing of bills of exchange as simply the mechanics or mode by which payment is to be effected. We think a practical man would find it unrealistic if it were suggested to him that if interest charges were included in the bill of exchange for the price, liability for tax would arise but not if a separate bill of exchange is drawn for the interest. It is evident from the agreement concluded between M. and the buyers that after April 1970, the sale of garments will be on 180 days credit terms for which interest is payable for the credit extended in addition to price. The legal effect of such an agreement is that one reads into every contract for the sale of garments (unless modified to the contrary) a stipulation that interest in addition to the price is payable under the contract. As concurrent obligations arise under the contract for payment of both price and interest by virtue of M.'s agreement with the buyers, the interest charges are inextricably bound up with and inseparable from the transactions for sale. We note that in the form of the bill of exchange used by M. and produced in evidence, the bill of exchange for the price dated 1st December 1971, was on "180 days, D/A" terms. Likewise, the bill of exchange for interest, dated one day earlier, was also on "180 days,

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D/A” terms. The significance of this shows that delivery of the consignment was not only against acceptance of the bill for the price but also against acceptance of the bill for the interest : a situation consistent with what we have stated above. It is clear, therefore, that interest charges are part and parcel of the same transaction. This being so, we agree with the Commissioner’s representative that one cannot, by some form of dichotomy, treat the sale proceeds as being referable to Hong Kong but not the interest charges.

Applying the “practical hard matter of fact test” we think that the sums received by way of interest were derived from the Colony. Apart from the reasons given above, it is our view that the source of interest flowed from the credit made available by M. in Hong Kong to the buyers; it was the grant of credit in Hong Kong from which sprang the obligation to pay interest. The assessment is, therefore, confirmed.