

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. BR 68/77

Board of Review:

S. V. Gittins, *Chairman*, W. T. Grimsdale, D. E. Steadman and B. H. Tisdall, *Members*.

14th March 1978.

Profits tax – Return/Dealing Commission – subsidiary company of taxpayer established and maintained branch office in Japan – Japanese office of benefit to U.K. company dealing in Japanese securities – subsidiary company did not manage investments in Japanese securities – U.K. company paid to taxpayer part of the commission it received in respect of transactions in Japanese securities – whether payments described as return/dealing commission arose in or were derived from the colony.

The taxpayer was a joint venture company registered in Hong Kong of company A and company B both registered in Hong Kong. The taxpayer dealt in investments, funds and shares.

Company BB which was registered in U.K. and was the parent company of company B, wished to expand its dealings in Japanese securities on behalf of its U.K. client's and required a "presence" in Tokyo. In consequence, the taxpayer incorporated a subsidiary company which established and maintained a branch office in Tokyo. The subsidiary company of the taxpayer which did not manage investments in Japanese securities was expected to be of benefit to the U.K. company but unprofitable for the taxpayer and for company A. In return for the imbalance, the U.K. company paid the taxpayer part of the commission it received in respect of dealings in Japanese securities. These payments which were shown as income items in the taxpayer's accounts were described as "Return and Dealing Commission on Japanese Transactions."

The control and management of the subsidiary company was exercised from its Hong Kong head office which was in turn controlled by the taxpayer. Cost of establishing and maintaining the Japanese office was borne by the taxpayer. It was common ground that such services as rendered by the taxpayer on behalf of the U.K. company were incidental and of small consideration.

The taxpayer sought to reduce its assessable profits by the amounts of "return/dealing commission" on the basis that the payments being calculated on the value of the U.K. company's dealings in Japanese securities, were income derived from a source outside Hong Kong. Alternatively, the taxpayer argued that the payments were gifts and not taxable.

On appeal.

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Decision: Appeal dismissed. Assessment as determined by the Commissioner confirmed.

A. L. Brown of Lowe Bingham & Mathews for the appellant.

A. K. Gill, Assessor, for the Commissioner of Inland Revenue.

Reasons:

1. The Taxpayer has appealed to the Board of Review from the Determination of the Commissioner of Inland Revenue on Profits Tax Assessments for the Years of Assessment 1969-70 to 1974-75 inclusive.

2. The appeal falls to be determined on:-

(a) Whether payments received by the Taxpayer from B. B. Co. Ltd., a United Kingdom company, under the head of "Return/Dealing Commission" in the years of assessment under appeal were derived from a source outside the Colony; and

(b) Alternatively, whether these payments were a gift to the Taxpayer.

3. In respect of the Return/Dealing Commission, the Taxpayer had included in its assessable profits, \$107,131 for the year ended 31/12/70. The rejection by the Commissioner of its claim under section 70A of the Inland Revenue Ordinance for the reduction of its assessable profits by this amount is the subject of appeal for the year of assessment 1969/70 under paragraph 2(a) or (b). It is common ground that the same principles will apply to this year of assessment as to the other years where the Taxpayer had excluded the Return/Dealing Commission from its returns for tax purposes.

RETURN/DEALING COMMISSION

4. Relevant agreed facts and others found by us from the evidence adduced are as follows:-

(1) The Taxpayer is a company incorporated in Hong Kong to carry on the business of an investment company, trust funds, mutual funds, provident funds, superannuation funds, portfolio managers and advisers, share underwriter and share trader.

(2) It is a joint venture company of A. & Co. Ltd. and B. Ltd., with its shares held equally by the 2 principals.

(3) B. B. & Co. Ltd., the U.K. company, wished to expand its dealings in Japanese securities on behalf of its U.K. clients and required a "presence" in Tokyo. As a result of discussions between its directors and those of A. & Co. Ltd., and after consideration of the tax position in Japan and possibly elsewhere, A. B. (Far East)

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Ltd., a wholly owned subsidiary of the Taxpayer, was formed to carry out the Japanese operation through a branch office in Japan.

- (4) A. B. (Far East) Ltd. was expected to be unprofitable and would require to be subsidised by the Taxpayer.
- (5) It was recognised by the principals that the presence of A. B. (Far East) Ltd. in Japan would benefit B. B. but would be of little or no benefit to A. & Co. Ltd., at least in the near future.
- (6) To meet this imbalance it was agreed that B. B. & Co. Ltd. would make payments to the Taxpayer by way of a commission of 0.15% on the value of all of B. B. & Co. Ltd.'s Japanese securities transactions. This commission was described as "Return/Dealing Commission" and was a part of the commissions received by B. B. & Co. Ltd. in respect of their transactions in Japanese securities.
- (7) The Return/Dealing Commissions paid by B. B. & Co. Ltd. to the Company during the four periods ending 31st December 1973 were as follows-

<i>Period</i>	<i>Amount</i>
23/1/70 to 31/12/70.....	\$107,131
Year ended 31/12/71	\$902,968
Year ended 31/12/72	\$957,328
Year ended 31/12/73	\$820,821

This commission was credited to the Company's accounts as an income item described as "Return and Dealing Commissions on Japanese Transactions".

- (8) The control and management of the Japan branch of A. B. (Far East) Ltd. was exercised in and from its Hong Kong head office, which in turn was controlled by the Taxpayer.
- (9) "Investment Management Fees" were paid by the Taxpayer to A. B. (Far East) Ltd., and claimed by the Taxpayer as an expense chargeable against their Hong Kong income in their Hong Kong tax computations, although A. B. (Far East) Ltd. did not manage investments in Japanese securities, for reason that this would have made the income from the Japanese investments of its parent company (the Taxpayer) liable to Japanese taxation.
- (10) Other services rendered by the Taxpayer to B. B. & Co. Ltd. included:-
 - (a) the preparation in Hong Kong of a newsletter on investment in Japan, which newsletter was supplied to clients of B. B. & Co. Ltd. in the U.K.

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(b) Discussions with B. B. & Co. Ltd.'s clients held by the Managing Director of the Taxpayer on his visits to the U.K.

(c) Conducting visits to Japan by clients of B. B. & Co. Ltd.

5. We find that the overwhelmingly major consideration for the payment of Return/Dealing Commission was the establishment and maintenance in Japan of the branch office of A. B. (Far East) Ltd., the cost of which was borne by the Taxpayer. We find that the other services rendered by the Taxpayer to B. B. & Co. Ltd. are incidental services and of small consideration.

6. We are of the opinion that the fact of the Return/Dealing Commissions being calculated on the value of B. B. & Co. Ltd.'s dealings in Japanese securities is irrelevant, that this is a mere yardstick to determine the amount of the payments.

7. The agreement for the joint venture formation of the Taxpayer company was made in London between B. B. & Co. Ltd. and A. & Co. Ltd. Then there was an agreement between B. B. & Co. Ltd. and the Taxpayer, directly or through A. & Co. Ltd., for the Taxpayer to incorporate the subsidiary A. B. (Far East) Ltd., and for the subsidiary to establish and maintain an office in Tokyo. These were activities of the Taxpayer in Hong Kong which were the consideration for the Return/Dealing Commission.

8. We are of the opinion that the establishment and maintenance in Japan of the office of its wholly owned subsidiary was an activity of the Taxpayer in Hong Kong and that the Return/Dealing Commission received by the Taxpayer therefor arose in and was derived from the Colony.

9. It follows that we find that the Return/Dealing commissions are not gifts. Indeed, this is conceded by the Taxpayer's then Managing Director in evidence.

10. The appeals with respect to (a) and (b) in paragraph 2 above concerning the "Return/Dealing Commission" are dismissed by the unanimous decision of the Board.