INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D10/95

Profits tax – source of profit – whether arising in or derived from Hong Kong.

Panel: William Turnbull (chairman), Kenneth Ku Shu Kay and Yu Yui Chiu.

Dates of hearing: 28, 29 November 1994 and 14, 27 February 1995.
Date of decision: 11 May 1995

The taxpayer was a private limited company carrying on business in Hong Kong. Its business was the sale of products which were purchased from its wholly owned subsidiary. The taxpayer sold its products worldwide using independent agents called export managers. Counsel for the Commissioner submitted, inter alia, that if a person carrying on business in Hong Kong either purchased or sold goods in Hong Kong the resulting profit would be assessable to tax in Hong Kong. The representative for the Commissioner also submitted that in any event the profit should be taxable in Hong Kong.

Held:

It is necessary to look at all of the relevant facts. Either buying or selling of goods in Hong Kong is not, of itself, sufficient. In the present case the goods were purchased in Hong Kong and sold outside of Hong Kong. In the present case selling was more important than buying. The selling took place outside of Hong Kong and accordingly the profits were not taxable in Hong Kong.

Appeal allowed.

Cases referred to:

CIR v Hang Seng Bank Limited [1991] 1 AC 306
CIR v HK-TVBI [1992] 2 AC 397
CIR v Hang Seng Bank Limited [1989] 2 HKTC 614
CIR v Karsten Larssen [1951] 1 HKTC 11
CIR v Hong Kong & Whampoa Dock Co Ltd [1960] 1 HKTC 85
CIR v International Wood Products Ltd [1971] 1 HKTC 551
CIR v Wardley Investment Services [1992] 3 HKTC 703
Commissioner of Income Tax, Bombay Presidency and Aden v Chunilal B Mehta of Bombay [1938] LR 65 Ind App 332
D59/92, IRBRD, vol 8, 63
Exxon Chemical International Supply SA v CIR 3 HKTC 57

Warren Chan for the Commissioner of Inland Revenue.

Adrian Huggins instructed by Messrs Johnson Stokes & Master for the taxpayer.

Decision:

This is an appeal by a limited company against a determination by the Commissioner of Inland Revenue wherein the Commissioner decided that certain profits arose in or derived from Hong Kong in terms of section 14 of the Inland Revenue Ordinance (the IRO).

Facts

The primary facts are as follows:

1. The Taxpayer was incorporated in Hong Kong as a private limited company in February 1974. It commenced business soon after its incorporation.

2. The Taxpayer carried on business in Hong Kong. Its business comprised the sale of products which were purchased from its wholly owned subsidiary, 'A Limited'.

3. The Taxpayer did not manufacture or source products for itself. It relied upon A Limited to find both products and manufacturers. A Limited would find and test the products before they were marketed by the Taxpayer and was responsible to ensure both quality and that there was an adequate supply of products at all times for sales by the Taxpayer. Products were purchased and physically brought to Hong Kong and warehoused in Hong Kong by A Limited. When products were sold by the Taxpayer the products were purchased by the Taxpayer from A Limited and were shipped by A Limited on the instructions of the Taxpayer from Hong Kong to the customers of the Taxpayer. Most products were brought to Hong Kong ready for sale but in some cases re-packaging or labelling was performed in Hong Kong by A Limited. A Limited made a profit on the price of the products which it sold to the Taxpayer and was also paid fee by the Taxpayer to cover the cost of the services which it provided.

4. The Taxpayer set up a chain of distributors around the world each of which was responsible for selling a line of products offered by the Taxpayer. The Taxpayer sold its products only to these distributors who acted as principals in relation to the purchase of products from the Taxpayer.

5. The Taxpayer had six principle lines of products. Each line of products had sixty to one hundred products comprised in it. Each distributor would normally only handle one line of products.

6. The Taxpayer placed great importance on its distributors. In each region where the Taxpayer sold its products it appointed individuals described as 'export

managers'. These export managers were independent agents contracted to the Taxpayer to perform certain services. These services were to find suitable persons to be distributors of the products of the Taxpayer, to train the distributors, to supervise distributors, and generally promote the sale of the products of the Taxpayer. The distributors sold the products of the Taxpayer through their own sales force or through sales agents appointed by the distributors.

7. The Taxpayer gave price list to its export managers. Based on these price lists the export managers as agents for the Taxpayer sold the products of the Taxpayer to the distributors. The sales by the export managers of the products took place outside of Hong Kong.

8. When orders were received by the Taxpayer from its distributors through its export managers the same were processed to Hong Kong. Instructions were given to A Limited to despatch the goods and payment was collected by the Taxpayer from the distributors in Hong Kong.

The Taxpayer called three witnesses to give evidence, one of whom was the chief executive officer and a director of the Taxpayer, one of whom was a director of the Taxpayer during the relevant years of assessment, and one of whom had been an export manager since 1985 up to the present date. The Board found all three witnesses to be truthful and accepts all of the evidence given by them. Only the first of the three witnesses was cross-examined by counsel for the Commissioner. As the facts of this case can be found in the evidence given by these three witnesses it is convenient for the Board to summarize the same in amplification of the facts found above.

The first witness was the chief executive officer and director of the Taxpayer. He informed the Board that the Taxpayer sold six lines of products to other companies known as 'distributors' on a worldwide basis.

He said that the Taxpayer appointed in each country or region of the world a person or persons known as an 'export manager'. By way of example he referred to Northern Europe where the Taxpayer had one export manager and the export manager had in turn three assistant export managers to assist him. The witness said that the Taxpayer was dependent upon the export managers to protect their business interests.

The witness said that the duties of export managers were the following:

(1) to install an adequate number of distributors in strategically located areas to provide readily available stock and service to all parts of the territory.

(2) to keep all distributors stocked with the full line of products in all sizes. To make certain that every product was adequately stocked in every market area.

(3) to see to it that every prospect was called on by one of the distributor's salesmen every 30 days.

(4) to schedule self and assistants so that maximum objectives would be achieved for minimum costs. To see that most trips were of a reasonably long duration so that a maximum amount of objectives could be achieved on each trip for minimum travel costs.

(5) to plan own time so that not more than one day per quarter was spent on non-field, sales training activities, such as office work.

(6) to see that company programmes were carried out including:

(a) Liberal use of advertising souvenirs;

(b) Proper use of sales programmes;

(c) Excellent market penetration;

(d) That distributors employed enough salesmen so that every prospect was seen monthly;

(e) That all distributors' salesmen wrote an average of 3 or more orders per day.

(7) To control and keep an inventory of all company property and sales equipment.

(8) To properly appoint, train and supervise assistants (now known as management consultants).

(9) To arrange for all distributors to pay on shortest payment terms. This went for all divisions. New product line distributors should be placed on LC sight or 30 days if possible and more liberal terms follow only when these terms could effectively be used as an inducement to put out more salesmen and place larger orders.

(10) To establish goals for the over-all territory and each assistant based on:

(a) An adequate number of orders daily based on a 5½ day selling week;

(b) An adequate volume;

(c) An adequate number of salesmen with each distributor;

(d) An adequate number of distributors;

(e) Stock levels of all products with each distributor to be adequate;

(f) Product mix sold by each salesman to be such that the full product line is regularly sold.

(11) To regularly inspect distributor's warehouses to make certain no competitive products were stocked and that the Taxpayer's products were properly stored and maintained.

(12) To maintain a high level of enthusiasm among all distributors, distributors' employees, management consultants and customers regarding the Taxpayer group of companies, the companies' products and policies and managers and employees.

(13) To schedule himself and all assistants (management consultants) so that all time between 7:00 a.m. and 5:30 p.m. on weekdays and 7:00 a.m. and 1:00 p.m. on Saturdays are spent in field-training, and calling on customers. Sales meetings etc should all be in the evenings or on Saturday afternoons.

(14) To appoint additional distributors whatever indicated for full territory coverage and complete market penetration.

The witness said that the Taxpayer required export managers to strictly comply with their responsibilities and any modifications of their terms of appointment were agreed between the Taxpayer and the export manager.

The witness likened the export managers to the sales team or sales force of the Taxpayer. They had direct contact with the distributors who were the customers of the Taxpayer. The witness then explained how export managers were found by the Taxpayer and appointed by the Taxpayer.

The witness went on to explain in some detail how export managers were trained by the Taxpayer. This was done in various ways which comprised 'hands on' training in the areas where the export manager would work. Training was undertaken by senior management from Hong Kong or by other export managers. The Taxpayer would assess export managers by monitoring the number of distributors that an export manager appointed and by the amount of business that he generated in his territory.

Once an export manager had been appointed to a country it was his responsibility to develop the business in that country because the Taxpayer in Hong Kong could not do it. The export manager would develop the business by appointing distributors who were the customers of the Taxpayer.

Distributors were under an obligation to maintain an adequate stock of the products of the Taxpayer and distributors were not allowed to return goods to the Taxpayer after they had been purchased.

It was the responsibility of the Taxpayer to supply sales literature and materials and samples to the distributors.

The export managers trained the distributors and the agents of the distributors to market and sell the products in accordance with the manuals which were supplied to each distributor and its sales agents by the Taxpayer.

The witness said that sales transactions were processed as follows:

(i) An order sheet evidencing the sale of the product by the Taxpayer to the distributor was signed by the distributor and the export manager for the Taxpayer.

(ii) A letter of credit was issued by the bankers of the distributor to the bankers of the Taxpayer to be negotiated by the Taxpayer in Hong Kong.

(iii) An invoice was issued to the distributor which was prepared by the Taxpayer in Hong Kong.

(iv) A packing and weight list was prepared and issued to the distributor by the Taxpayer in Hong Kong.

(v) A shipping advice addressed to the distributor was sent by the Taxpayer from Hong Kong enclosing the bill of lading, and other documents and giving details of the ship and its schedule.

(vi) The goods were insured with a Hong Kong company by the Taxpayer.

(vii) A bill of exchange was drawn by the Taxpayer on the distributor.

The witness said that export managers were required to post or fax to the Taxpayer in Hong Kong all order sheets. At the end of each week each export manager sent to the Taxpayer in Hong Kong a report of his activities for that week. The Taxpayer in Hong Kong kept a record of the number of visits made to each distributor by each export manager.

With regard to the purchase of products by the Taxpayer the witness explained that this was undertaken by A Limited. There was a close relationship with the suppliers of the products. A Limited had long term contracts with the many factories which supplied the products. All orders were issued by A Limited in Hong Kong to the manufacturers and the goods were shipped by the manufacturers to A Limited in Hong Kong. When manufacturers brought out new products they would approach A Limited to ascertain whether or not it would be interested in purchasing such new product. A Limited had a product manager who would inspect and test the new product in Hong Kong to see if it complied with the standard of the Taxpayer. If A Limited did not have the ability to test new products this work would be contracted out to other companies either in Hong Kong or overseas.

The product manager of A Limited usually visited manufacturers annually, most of whom were in the USA. He would also attend trade shows and trade fairs in USA to see if there were any new products which could usefully fit into any of the lines sold by the Taxpayer. Occasionally a manufacturer's representative would meet the product manager in Hong Kong.

A Limited sold the goods to the Taxpayer at cost together with a margin to assist in the payment of the expenses of A Limited. Most of the Hong Kong based staff were employed by A Limited. The Taxpayer itself had few Hong Kong resident employees. The relevant orders and invoices were computer generated in that whenever stock was withdrawn from the warehouse to be shipped to a distributor, the computer would automatically make the adjustments to the inter company accounts between A Limited and the Taxpayer. Effectively there were no written documents passing between the Taxpayer and A Limited.

A Limited received the goods at its warehouse in Hong Kong. Many of the products were already packaged and labelled with the labels of the Taxpayer. A Limited re-packaged certain goods on behalf of the Taxpayer in Hong Kong and arranged for labelling of certain packages on behalf of the Taxpayer.

The witness explained that the purpose of the Taxpayer having a wholly owned subsidiary to purchase goods was to ensure that distributors and export managers were unable to purchase the products of the Taxpayer direct from the manufacturers.

The witness explained that A Limited maintained a warehouse in Hong Kong to store and ship goods. A Limited attended to the warehousing and shipping of the goods, product development and inventory allocation. The Taxpayer covered the sales of the goods including the production of advertising materials. Payment was usually made to the Taxpayer through the bankers of the Taxpayer in Hong Kong. When letters of credit were received instructions were given to A Limited to prepare the shipment. If the distributors enjoyed a good relationship with the Taxpayer the goods would be shipped immediately upon receipt of the order prior to payment.

The witness said that there was always sufficient stock to satisfy orders from distributors. Stock of between two months to four months was usually maintained in Hong Kong based on historic information and forecasts. If there was not sufficient stock, orders were immediately placed with manufacturers. However goods were never supplied to distributors by manufacturers but always by the Taxpayer through A Limited in Hong Kong.

The Taxpayer did not advertise and promote its products on its own behalf but relied upon its export managers to promote its products.

Counsel for the Commissioner cross-examined this witness with regard to the authority of export managers to conclude contracts on behalf of the Taxpayer. The witness was able to state that export managers had full authority to accept orders for products on behalf of the Taxpayer. The witness also confirmed that the Taxpayer did not itself maintain any stock of its products.

The second witness said that he had been a director of the Taxpayer from September 1976 to February 1992 and was familiar with the company's operations during the years of assessment from 1984/85 to 1991/92 being all of the years of assessment in question.

He said that the fundamental reason for the success of the Taxpayer was that great care was taken in the appointment of distributors who were given the exclusive right to sell products of the Taxpayer in a particular country or territory. He said that the Taxpayer was also very careful to ensure that the export managers, the distributors and the sales agents were properly trained with regard to the sale and use of the products and to ensure that the distributors were visited on a regular and frequent basis. He also attributed the success of the Taxpayer to ensuring that the distributors were properly stocked with high quality goods. He said that all of the work in locating distributors and training export managers, distributors and their sales agents took place outside of Hong Kong.

The witness described how he had established the network of export managers and distributors when the Taxpayer began business and demonstrated that this took place outside of Hong Kong. He confirmed the evidence given by the preceding witness with regard to the appointment and duties of export managers. He further stressed the importance of the export managers and distributors to the business of the Taxpayer.

The witness was also able to confirm the procedure followed by the Taxpayer in purchasing its goods through A Limited. A Limited issued orders for goods in Hong Kong to the manufacturers and the products were shipped by the manufacturers to A Limited in Hong Kong. A Limited then sold the products in Hong Kong to the Taxpayer. The Taxpayer then on sold the goods to the distributors in various parts of the world.

The third witness was one of the export managers of the Taxpayer covering a number of European countries. He explained the range of products offered by the Taxpayer and how the Taxpayer sold its products to distributors. The distributors would then on sell the products through their own sales agents and sales force to ultimate customers. He pointed out that sales transactions between the distributors and their own customers were no concern of the Taxpayer. He said that it was his duty to identify the distributors and to train them. It was also his duty to negotiate, conclude and execute sales of the products with the distributors for and on behalf of the Taxpayer. He described how he performed his duties in some detail.

The export manager said that he was given a price list by the Taxpayer. It was then his duty to obtain orders from distributors and sell the products of the Taxpayer to the distributors. He would visit the distributors and advise them and negotiate with them the products which they should buy and the price for such product. When he and the distributors had reached an agreement an order would be filled out and signed by the distributors and himself. He said that he acted as the agent of the Taxpayer and had full power to act on behalf of the Taxpayer.

Neither the second director nor the export manager was cross-examined by counsel for the Commissioner.

Submission by Counsel for the Taxpayer

Counsel for the Taxpayer addressed the Board. He said that the facts found by the Commissioner in his determination were not only unchallenged by the Taxpayer but were relied upon by the Taxpayer. He said the essential facts were as follows:

The Taxpayer was incorporated in Hong Kong in 1974.

Its main business consisted in the trading of certain products.

These products were manufactured by third parties overseas and purchased by the Taxpayer through its wholly owned Hong Kong subsidiary, A Limited.

The products were sold to various distributor companies around the world by independent agent 'export managers' of the Taxpayer who were operating in those overseas countries.

A Limited was incorporated in Hong Kong in 1973.

A Limited was formed as a separate entity to protect the identity of the overseas manufacturers and suppliers from the independent agents and distributors.

The Taxpayer paid management fees to A Limited to cover the handling charges for the supply of the trading stock for the Taxpayer.

The Taxpayer recruited the export managers in several countries around the world to sell the product lines on its behalf.

All of the work in training the export managers and in locating the distributors took place wholly outside Hong Kong.

Through the efforts of the export managers overseas, offshore sales were made to the overseas distributors.

The export managers were each given a set of offshore recommended selling price lists by the Taxpayer but they had the authority to determine the final price structure in negotiating and executing sales contracts with the overseas distributors.

Formal written agreements were entered into between the export managers and the Taxpayer which set out the duties of the export managers in the particular country concerned.

Over 90% of the export managers did not visit Hong Kong (although some did come to Hong Kong on family holidays). The export managers were responsible for the appointment of the overseas distributors and for the development and maintaining of a profitable network.

The export managers also provided training to sales personnel of the distributors, and they visited the distributors and obtained restocking orders.

Although sales prices were fixed, the export managers were delegated with the authority and discretion to fix the sales prices in order to obtain contracts and sell the goods. The goods were then obtained from stocks already stored in A Limited's warehouse in Hong Kong. They were shipped directly to the distributors.

Each of the products was sold to the end user by the offshore distributors. Therefore, the Taxpayer did not keep any records relating to the end customers because their concern was limited to the agents and distributors.

Counsel said that in summary, the sales of the goods were concluded on behalf of the Taxpayer by the export managers directly with the distributors. The goods were shipped directly to the distributors in the various countries, with the office of the Taxpayer in Hong Kong attending to the shipping documentation and similar details.

Counsel for the Taxpayer then referred us to the relevant law and in particular to CIR v Hang Seng Bank Limited [1991] 1 AC 306 and CIR v HK-TVBI [1992] 2 AC 397 and addressed us on the law in the following terms (the emphasis was that of Counsel):

The only law arising in this appeal is that relating to the correct approach to the determination of the source of the Taxpayer's profits which the CIR has sought to make chargeable to tax under section 14 of the IRO.

Ultimately the question is one of fact. But it is a question which can only be determined against the background of a prior legal analysis of the nature of the relevant transactions involved.

Section 14: Main Charging Provision

A charge on profits under section 14 of the IRO is dependent upon 3 separate and distinct conditions being satisfied. If any one of these 3 conditions is unfulfilled, section 14 does not bite at all. They are:

(a) the Taxpayer must carry on a trade, profession or business in Hong Kong;

(b) the profits must be profits of that trade, profession or business carried on in Hong Kong; and

(c) the profits must also be profits arising in or derived from Hong Kong.

Each of these three conditions or prerequisites are entirely independent.

The Board should be concerned in this appeal only with the third.

A fundamental distinction must be made between:

(1) those profits arising in or derived from Hong Kong; and

(2) those profits arising in or derived from a place outside Hong Kong: Hang Seng Bank, at pages 318E-G and 319B.

Profits and Geographical Source

A Taxpayer is assessed in relation to his *assessable* profits [section 2(1)].

Assessable profits can have no geographical location.

It is the Taxpayer's *gross* profits (or income) from individual transactions which, when aggregated and after deduction of aggregated expenses, give rise to net, or assessable, profits: Hang Seng Bank, at page 319B-C.

To identify whether any profit is assessable it is necessary to identify first the *gross* profit, or income, arising from the relevant transaction or series of transactions: Hang Seng Bank: page 319C-D and then to determine the location of that gross profit, or income: Hang Seng Bank, at page 319D-H.

This distinction between *assessable* profit and *gross* profit (or income) is recognised in Revenue Rule 2A(1).

Need to distinguish Source and Location

The source of profit is determined by reference to the actions undertaken by the taxpayer out of which the profit arises.

The location of profit is determined by reference to the place where those actions were undertaken.

One determines location of the profit by reference to the place where the actions undertaken took place: Hang Seng Bank, at pages 315D, 319G, 332G-323C, and CIR v HK-TVBI Ltd [1992] 2 AC 397 (PC), at page 407C-D.

The broad guiding principle

The one broad principle of law, which should guide both the CIR and the Board of Review in cases of this kind, is to be found in the advice of the Privy Council in CIR v Hang Seng Bank Limited [1991] 1 AC 306 at page 322H-323B:

> '*… 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.*'

On the facts the Privy Council were not required to deal in the Hang Seng Bank case with the situation which arises in a case like the Taxpayer's in which goods were purchased in one territory and thereafter income and profit arose from their sale in another. (In both that case and this the profits arose from sales effected through overseas agents.)

What profit-earning activities must be looked at?

The advice of the Privy Council in the Hang Seng Bank case did not deal expressly with the question of whether the activities of overseas agents of the taxpayer can be looked at in determining the source of any profits, although on the facts of the case itself it is clear that the Privy Council did have regard to the profit-producing operations of the Taxpayer's agents in Singapore.

So did the Court of Appeal in Hong Kong in the same Hang Seng Bank case. Counsel for the Commissioner produced a lengthy list of activities carried on by the Taxpayer bank in Hong Kong, and in response to that the Court of Appeal said this:

> *'What [counsel for the commissioner] has omitted from his list is that the profits arose from trading in securities which took place outside of Hong Kong through agents and in markets which were outside of Hong Kong …'* - [1989] 2 HKTC 614 at page 630.

The present appeal by the Taxpayer is based on the proposition that approach was entirely correct, and that the Board of Review must look at what was done by the Taxpayer through its overseas agents in determining what the Taxpayer did to earn the profit in question.

Although the Hang Seng Bank case talks expressly of 'looking to see what the taxpayer has done to earn the profit in question', the Privy Council had regard (quite rightly) to the activities of overseas agents of the taxpayer, on the basis (impliedly) that qui facit per alium facit per se (he who acts through another acts himself).

Strangely this issue of whether the activities of the Taxpayer's overseas agents should be looked at in this context has not been consistently dealt with in Hong Kong.

In CIR v Karsten Larssen [1951] 1 HKTC 11 the taxpayer was a Hong Kong company affiliated with a Scandinavian shipowner. The profits in question were commissions paid to the taxpayer as a result of its assistance in arranging shipchartering transactions between the shipowner and third parties outside Hong Kong. In so far as the taxpayer had delegated responsibilities to an offshore agent, and the taxpayer's profits resulted from the agent's activities outside Hong Kong, the question arose as to whether those agent's operations should be looked at in determining what earned the taxpayer's profits.

Gould J seems to have thought not, since he took the view that because all of the taxpayer's own activities took place in Hong Kong, its profits arose in Hong Kong,

notwithstanding the direct connection between the receipt of the profits and the offshore transactions arranged and effected by offshore agents.

In the CIR v Hong Kong & Whampoa Dock Co Ltd [I960] 1 HKTC 85 Reece J did not refer to the Karsten Larssen case but he did emphasise the importance of the particular activities which were necessary to the earning of the particular profit, including the making of the relevant salvage contract concluded by the taxpayer's agent outside Hong Kong. So he impliedly thought that the activities of the agent outside Hong Kong should be looked at.

CIR v International Wood Products Ltd [1971] 1 HKTC 551 also required a decision as to whether the activities of offshore agents should be taken into account in determining the source of a Hong Kong taxpayer's profits.

The Board of Review held that the taxpayer's profits arose outside Hong Kong, finding that the operations that produced the profits were those of the taxpayer's agents outside Hong Kong. The Board recognised that the Karsten Larssen case was not favourable to the taxpayer but said that it 'should be regarded as impliedly overruled by the Full Court in the Hong Kong & Whampoa Dock case if and in so far as it is applicable to the appeal to the Board': [1971] 1 HKTC 551 at page 556.

On appeal to the Supreme Court, Blair-Kerr J upheld the decision of the Board of Review in favour of the taxpayer. After distinguishing both Karsten Larssen and the Hong Kong & Whampoa Dock case and stressing the lack of evidence of any profit-generating activity in Hong Kong, he approved the Board's conclusion that the 'prime cause of the profits was the orders obtained by the sub-agents' (page 566).

Counsel for the Taxpayer submitted that the International Wood case supports the view that regard should be had, not only to the operations and activities of the taxpayer directly, but also to those of independent agents that produce profits for the taxpayer.

However he said that Blair Kerr J in International Wood did not address this question expressly. Nor did he express any opinion as to the correctness of the Karsten Larssen decision.

Blair Kerr J simply noted that the offshore brokers in that case had no authority to enter into charter contracts without specific authority from the Hong Kong taxpayer. Counsel said that in contrast, the sub-agents of International Wood appeared to operate independently of any control from Hong Kong.

Most recently in CIR v Wardlev Investment Services [1992] 3 HKTC 703 the taxpayer, Wardley, was a Hong Kong based investment adviser engaged in managing investment funds for customers. All of its offices and employees were in Hong Kong. It bought and sold securities on behalf of its customers using its own judgement and discretion as though it were the beneficial owner of the funds. Purchases and sales were made in Hong Kong and also in overseas markets through stockbrokers. The stockbrokers' commissions were paid by Wardley out of the customers' funds.

Wardley periodically received from each customer a management fee equal to a percentage of the funds under management. In addition, Wardley was permitted, under the management agreements between it and its customers, to keep for its own benefit any rebates from the stockbrokers employed by Wardley to buy or sell securities.

Wardley reported rebates received from Hong Kong stockbrokers as taxable income arising in Hong Kong, but claimed that rebates received from stockbrokers elsewhere were not taxable because they did not arise in Hong Kong. But the Commissioner assessed tax on the rebates relating to offshore transactions, saying that they arose in Hong Kong because they constituted consideration for management services performed in Hong Kong. The Board of Review held in favour of the taxpayer.

By a majority of 2-1 the Court of Appeal over-ruled the Board and held in favour of the Commissioner, but the two majority judgements differ in their approach and reasoning.

Fuad V-P said that the Board of Review had erred in taking into account the operations of the overseas brokers, notwithstanding that they were acting as Wardley's agents in the foreign markets. He said in effect that the Board should have looked only at what Wardley itself ('the taxpayer') did:

> *'The Taxpayer, while carrying on business in Hong Kong instructed the overseas broker from Hong Kong to execute a particular transaction … The Taxpayer did nothing abroad to earn the profit sought to be taxed … The profit to the Taxpayer was generated in Hong Kong from [the management] contract although it could be traced back to the transaction which earned the broker a commission.' - page 729*

Counsel said that surprisingly Fuad V-P did not deal at all with the fact that in the Hang Seng Bank case the taxpayer bank had done nothing itself abroad but had instructed overseas brokers (independent agents) to execute particular transactions.

Penlington J said that in his opinion Wardley did not receive the rebates from the overseas brokers but rather from the customers in Hong Kong: pages 731-732. (He did not address the issue of whether the activities of the overseas agents should be looked at.)

Cons V-P, dissenting, said that what Wardley did to earn the rebates was 'to put business in the way of an overseas broker'. This was done from Wardley's base in Hong Kong, but the brokers' commissions from which the rebates were derived did not arise in Hong Kong and 'it is difficult to see what [Wardley] has done *vis-a-vis* the customer to earn that particular piece of remuneration'; (pages 730-731).

Counsel for the Taxpayer submitted that far from applying Hang Seng Bank, the majority in Wardley misapplied it. In Hang Seng the Privy Council did look at what was done to earn the profit both by the Taxpayer directly and through its agents overseas.

In conclusion counsel for the Taxpayer submitted that the correct approach, as a matter of principle, is to look at what activities actually earned the profit, and if those activities were carried out substantially and primarily outside Hong Kong by agents of the taxpayer, then the profits ought not to be taxable.

Thus, in the present case he said that regard must be had both to what was done by the Taxpayer itself in Hong Kong to effect the sales (that is, in fact nothing or next to nothing) and to what was done directly and primarily by the Taxpayer's agents overseas.

Qui facit per alium facit per se (he who acts through another acts himself). A person need not be formally appointed an agent in order to be an agent. An agency may be implied as well as express and can arise through ratification.

Counsel for the Taxpayer also addressed us with regard to an alternative argument if we were to find that the profit arose from two sources or activities. This part of counsel's argument is not considered to be relevant in the light of the decision which the Board has reached. Counsel then addressed us as to how profit should be calculated. Finally he took us through the Commissioner's determination and the grounds of the Taxpayer's appeal. We do not think it necessary for us to set out the submission made by counsel in reply to the Commissioners determination as this appeal was fully argued by both counsel before us ab initio and we had the benefit of hearing evidence which was not available to the Commissioner.

Submission by Counsel for the Commissioner

Counsel for the Commissioner addressed us on the relevant law in the following terms.

Three conditions must be satisfied before a charge to tax can arise under section 14:

(a) The taxpayer must carry on a trade, profession or business in Hong Kong.

(b) The profits to be charged must be from the trade, profession or business carried on by the taxpayer in Hong Kong.

(c) The profits must be profits arising in or derived from Hong Kong.

Hang Seng Bank, page 318 lines E and F.

The structure of section 14 pre-supposes that the profits of a business carried on in Hong Kong may accrue from different sources, some located within Hong Kong, other overseas.

Hang Seng Bank, page 318 lines E and F.

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.

Hang Seng Bank, page 322 line H.

The guiding principle is that one looks to see what the taxpayer has done to earn the profit in question, and where those operations took place.

Hang Seng Bank, page 323 lines A and B.

HK-TVBI, page 409 at lines E and F.

If the profit was earned by dealing in commodities by buying and reselling at a profit, the profit will have arisen in or derived from the place where the contracts of purchase and sale were effected. The transactions are two-fold, namely, the purchase and the re-sale.

Hang Seng Bank, page 323 at lines A to C.

HK-TVBI, page 407 at lines E to G, page 409 at lines B to C.

The Hang Seng Bank Case

The facts

(a) The Bank was managed in Hong Kong. It had no branch outside Hong Kong.

(b) The Bank in Hong Kong made decisions to buy and to sell certificates of deposit.

(c) Both the buying and the selling of the certificates of deposit took place outside Hong Kong through agents.

CIR's argument

(a) In determining the source of the profit, the circumstances that a bank was managed in Hong Kong and had no branch outside Hong Kong is relevant. This does not mean worldwide tax. The question depends on how the entire activities of the taxpayer are organised.

(b) The critical question is whether the offshore activities of the bank are free-standing or embedded into the domestic operations of the taxpayer in Hong Kong.

(c) The certificate of deposit transactions were transactions of the business of its head office in Hong Kong. The facts show that the overseas profits were

so embedded in the Hong Kong business of the Bank that they cannot be separated from it.

Hang Seng Bank's argument

(a) There were Hong Kong elements in the transactions. The Bank's decision and instructions are not relevant because income does not arise from the giving of instructions or from research which leads to them.

(b) The Bank had to buy and sell certificates of deposit in foreign markets to earn the particular income, and the Bank's profits from the transaction were transaction from business transacted outside Hong Kong by an agent outside Hong Kong.

Judgment of Board of Review

(a) This form of income is trading income.

(b) The source of the income is not the source of the funds invested by the Bank but the activities of the Bank.

(c) The activities of the Bank from which the income arose was 'the buying and selling' of this property in overseas market places and not the decision making process in Hong Kong or any other activities in Hong Kong.

Judgment of Privy Council

(a) Lord Bridge laid down the guiding principle, and he gave some examples to illustrate the application of the principles.

(b) 'But the present case was a straight forward one where ... the decision of the Board of Review was fully justified by the primary facts and betrayed no error of law.'

(c) In other words, Privy Council adopted the proposition that income arose from 'the buying and selling'.

<u>The TVBI Case</u>

The facts

(a) TVBI is a Hong Kong company. TVBI acquired licence from TVB, which was the parent company of TVBI. It sent representatives abroad to solicit business and to negotiate terms.

(b) TVBI then granted sub-licences in Hong Kong to overseas customers. Sub-licences were sometimes signed overseas and sometimes through correspondence.

CIR's argument

(a) The business of TVBI was the acquisition of the films and the right to grant exclusive sub-licence and the granting of the sub-licences to its customers outside Hong Kong.

(b) TVBI's operations were fundamentally carried out in Hong Kong in that

(i) TVBI was in Hong Kong.

(ii) TVBI's sales organisation was in Hong Kong.

(iii) The representatives who were sent abroad were of the Hong Kong sales organisations.

(iv) The sub-licences were drawn up in Hong Kong according to Hong Kong law, and were despatched from Hong Kong.

(v) The films were either delivered or despatched from Hong Kong.

(vi) The films at the expiry of the sub-licence period had to be returned to Hong Kong or were destroyed.

(vii) Payments for the grant of the sub-licences were received in Hong Kong.

TVBI's argument

(a) TVBI carried on the business of sub-licensing. But it did not carry on the sub-licensing business from Hong Kong. TVBI's operations had three phases:

(i) the pre-contract phase in which business was solicited outside Hong Kong,

(ii) the making of the contracts, and

(iii) the performance of the contracts by TVBI in the overseas territories.

(b) TVBI either rendered services to its overseas customers or it exploited property assets abroad. The mere fact that the taxpayer carried out some activities in Hong Kong does not mean that the profits arose in or derived from Hong Kong.

Judgment of Privy Council

(a) The Privy Council applied the guiding principles laid down in the Hang

Seng Bank case.

(b) The Privy Council observed that in the Hang Seng Bank case, the two transactions which threw up the profit, namely the purchase and resale of the certificates of deposit, both took place outside Hong Kong.

(c) The transactions which produced the profit to TVBI were two-fold, namely the acquisition of the exclusive rights of granting sub-licences together with the films and the grant of sub-licences. TVBI's 3-phases argument ignores the fact that TVBI first had to acquire the right to grant sub-licenses.

(d) TVBI carried on business in Hong Kong, having acquired films and rights of exhibition thereof, exploited those rights by granting sub-licences to overseas customers. The relevant business of TVBI was the exploitation of film rights exercisable overseas and it was a business carried on in Hong Kong. The fact that the rights which they exploited were only exercisable overseas was irrelevant in the absence of any financial interest in the subsequent exercise of the rights by the sub-licensee.

(e) The Privy Council rejected the analogy of provision of service and exploitation of property assets.

The Ratio of the 2 Cases

(a) The guiding principle is that one looks to see what the taxpayer has done to earn the profit in question, and where those operations took place.

(b) In the case of profits arising from trading, there are 2 transactions which throw up the profit, namely the purchase and the resale.

(c) Where both the contract of purchase and the contract of sale are effected outside Hong Kong, no part of the profits are taxable. In the Hang Seng Bank case the Privy Council quoted the Board of Review:

> *'The activities of the bank from which the income arose was the buying and selling of this property …' (page 320 letters F and G)*

and held

> *'… But the present case was a straight forward one where, in their Lordships judgment, the decision of the Board of Review was fully justified by the primary facts and betrayed no error of law.'*

(d) Where either the contract of purchase or the contract of sale is effected in Hong Kong, the profits will be fully taxable. In the TVBI case the Privy Council stated:

'In the Hang Seng Bank case [1991] 1 AC 306 the two transactions which threw up the profit, namely the purchase and resale of the certificates of deposit, both took place outside Hong Kong ...' (page 407, letters D and E)

'… what were the transactions which produced the profit to the taxpayer. These transactions were two-fold, namely, the acquisition of the exclusive rights of granting sub-licences together with the relevant films and the grant of these sub-licences ...' (page 407, letters E and G)

'… Mr Park went on to argue that there were three phases in the operations carried out by the taxpayer … This approach ignores the fact that the taxpayer first had to acquire the right to grant sub-licences.'

'The profit-making activity of the sub-licensees was carried on outside Hong Kong but the grant of the sub-licences took place in Hong Kong where the taxpayer operated.' (page 411, letters A and B)

(e) No inconsistency

There are many similarities between the 2 cases. Both Hang Seng Bank and TVBI had their only or principal place of business in Hong Kong. Both the Hang Seng Bank case and the TVBI case involved (in substance) trading income. In the Hang Seng Bank case it is the purchase and sale of certificates of deposit. In the TVBI case it is the acquisition of licence/films and the sub-licence. Both marketed and sold their products outside Hong Kong. Given such similarities, why are the results different? The reason is that there is an important dissimilarity - which is that Hang Seng Bank purchased the certificates of deposit outside Hong Kong whereas TVBI acquired the rights in Hong Kong.

(i) In the Hang Seng Bank case both the purchase and the sale of the certificates of deposit took place outside Hong Kong. On such facts, the Privy Council held that the case was a straight forward one.

(ii) In the TVBI case, the Privy Council emphasised the two-fold transactions in the sub-licensing business, that is the purchase and the sale. Unlike the Hang Seng Bank case, in the TVBI case the acquisition took place in Hong Kong whereas marketing activities took place outside Hong Kong.

Counsel for the Commissioner then addressed us on the facts of the case and on applying the law to the facts in the following terms:

Nature of Business of the Taxpayer

The Taxpayer carried on business in Hong Kong, engaging in the trading of goods.

The Taxpayer purchased the products from A Limited in Hong Kong and sold the products to overseas distributors.

The Taxpayer's Purchase from A Limited

A Limited issued orders to overseas manufacturers. Overseas manufacturers shipped the products to A Limited in Hong Kong. A Limited maintained a warehouse to store the products. At any one time, A Limited maintained a stock inventory of approximately $20 million. A Limited sometimes repackaged the products and arranged for the labelling of certain packages.

The Taxpayer purchased the products from A Limited. The Taxpayer would give instructions to A Limited to prepare shipment either upon receipt of the order from the distributor or upon receipt of the letter of credit. Note: On the evidence, the sale to the distributors took place before the purchase from A Limited.

The price paid by the Taxpayer was at cost together with a margin to assist in the payment of A Limited's expenses. A Limited issued invoices to the Taxpayer. Payment was settled through inter-company account.

The Taxpayer also paid substantial management fees to A Limited. The amount of the management fees was determined by assessing the value of the procurement services to the Taxpayer and the cost of the services to A Limited.

The Taxpayer's Sale to Distributors

The Taxpayer trained export managers, who negotiated with distributors. Distributors placed orders with the Taxpayer. Export managers accepted orders on behalf of the Taxpayer. Orders were either posted or faxed to the Taxpayer in Hong Kong.

The products were shipped by the Taxpayer from Hong Kong to the distributors.

Applying the Law to the Facts

One looks to see what the Taxpayer has done to earn the profit and where those operations took place.

What has the Taxpayer done? Where did the operations take place?

(a) The Taxpayer trained export managers. This took place outside Hong Kong.

(b) Export managers (who were independent contractors and not agents) negotiated and on behalf of the Taxpayer concluded agreements with the

distributors. The export managers (and not the Taxpayer) did that outside Hong Kong.

(c) The Taxpayer received orders from distributors. This was received in Hong Kong. The Taxpayer was paid also in Hong Kong.

(d) The Taxpayer placed a corresponding order on A Limited; and A Limited sold the products to the Taxpayer in Hong Kong. The property in the products passed from A Limited to the Taxpayer; and A Limited delivered (albeit notionally) the products from A Limited to the Taxpayer. All these took place in Hong Kong.

(e) The Taxpayer paid cost plus expenses. The Taxpayer also paid substantial management fees to A Limited.

(f) The Taxpayer shipped the goods from Hong Kong to overseas distributors.

As this is a case of 'buying and selling' (Hang Seng Bank case), the transactions are 'two-fold' (TVBI case). Assuming that the sales were outside Hong Kong, the fact remains that the purchases were all done in Hong Kong. It follows that this is the TVBI situation and not the Hang Seng Bank situation; and thus the profits must be liable to profits tax.

The counsel for the Commissioner then went on to address us on the importance of the purchase aspect of the matter and that the Taxpayer had placed undue importance on the sales aspect. He pointed out that the Taxpayer had paid substantial sums of money to A Limited for its services in purchasing the goods. He submitted that no more importance should be paid to the place where goods are sold than to other aspects of a trading transaction.

Though counsel for the Commissioner seemed at one stage of his submission to suggest that the Commissioner was right when he said that the mere purchase or sale in Hong Kong by a trader is sufficient to make all of his profits taxable, this did not seem to be the main thrust of his argument. Rather he stressed that in a trading case one must look at both the purchase and the sale and that on the facts of the present appeal the profits made by the Taxpayer were attributable to the purchase rather than the sale and also to the other acts done by the Taxpayer in Hong Kong, for example, receipt of (accepted) orders and shipment of goods.

We are much indebted to both counsel for the thorough way in which they had researched the law relating to this appeal. They were able to explain and reconcile both the Hang Seng and the TVBI cases. We have recited above in some detail the submissions of both counsel. Obviously each counsel was hoping that the Board would find in their favour and accordingly were approaching the law and facts from different points of view but what was apparent to this Board was that, with one difference to which we refer later, both shared the same understanding of the law.

Their submissions are quite clear and with the exception of the one statement made by Mr Warren Chan, QC this Board is in total agreement with them. When looking for the source of income for profits tax purposes it is necessary first to ascertain what it is that the Taxpayer has done to earn the profit in question and then to find out where it was done. There is much authority for this simple proposition. The latest highest authority can be found in the TVBI case at page 407:

> *'Thus Lord Bridge's guiding principle could properly be expanded to read "one looks to see what the taxpayer has done to earn the profit in question and where he has done it".'*

and again at page 409:

> *'The proper approach is to ascertain what were the operations which produced the relevant profits and where those operations took place.'*

Mr Warren Chan QC confirmed that the Commissioner shared this view by saying:

> 'The guiding principle is that one looks to see what the taxpayer has done to earn the profit in question, and where those operations took place.'

The statement by Mr Chan which requires further consideration is the suggestion that where a trader either buys or sells goods in Hong Kong, any profit from that transaction will necessarily be subject to profits tax in Hong Kong.

The case before us is one of trading. The Taxpayer bought and sold products. In any trading case one must look at all of the facts but the acts of buying and selling are clearly important. Whether the one or the other is more important will depend upon the circumstances of each case. Obviously if a 'buyers market' or a 'sellers market' exists this is something which will be of importance but this is not the case before us. However the case before us is not simply the buying and selling of products.

The operations of the Taxpayer went further. To decide whether these operations in whole or in part contributed to the earning or creation of the profit one must look carefully at the facts and it is here that one runs into a problem. The Taxpayer itself did little. Most of what it did was done by agents or contractors. The business of the Taxpayer was the procuring, stocking and selling of a range of products.

The Taxpayer itself did not procure or stock the products. It used the services of its wholly owned subsidiary, A Limited. A Limited was not its agent in a legal sense. A Limited on its own account went out into the world and found suitable products. Much of this work was done in Hong Kong. A Limited then purchased the products in quantities which were estimated to be sufficient to meet the anticipated sales of the Taxpayer. The products were then sent to Hong Kong where they were warehoused by A Limited. As and when the Taxpayer made sales of the products, A Limited was notified and the products were despatched from Hong Kong.

It is important to note that A Limited was remunerated for its services by the Taxpayer and that A Limited was itself a trader in the products in question. There is no suggestion that the relationship between the Taxpayer and A Limited was artificial. Indeed counsel for the Commissioner stressed that the Taxpayer paid substantial sums of money to its subsidiary for the 'services' which he said the subsidiary performed for it.

The Taxpayer did little itself to earn the profits in procuring and stocking the products. All that the Taxpayer had to do was to pass on each order as it received it to A Limited and in due course to make payment to A Limited. Important tasks but not very onerous.

Selling is not just the act of selling. Selling involves much more than just the entering into a contract of sale and that is certainly the position in the case before us. First there must be a product which customers want to buy because of its price, quality, fitness to do a job and the service offered by the seller, whatever that may be. We have extensive evidence before us of the service offered by the Taxpayer. This was in the form of many export managers covering the countries in which the Taxpayer sold its products. Each export manager was trained in the use of the products and in turn trained distributors and others. The Taxpayer had a range of products in six separate lines. These were all essential elements in the trading business of the Taxpayer.

As with the procurement of products, the Taxpayer did little itself to sell its products. It relied on the services of its export managers. The export managers were all independent agents. They were not employees of the Taxpayer any more than A Limited was an employee of the Taxpayer. The Taxpayer paid the export managers for their services.

There was one big distinction between A Limited and the export managers. A Limited bought and sold products in its own right. It was itself a trader. This is in contrast to the export managers who acted as agents for the Taxpayer and were empowered to sell products in the name of the Taxpayer for and on its behalf.

It was not argued before us that the Taxpayer was carrying on its trading business overseas through its agents though that might have been a line of argument which the Taxpayer could have developed. As it did not do so we do not take the point. For the purposes of this decision we accept that the products were sold by the Taxpayer from Hong Kong to distributors in foreign countries and territories through its agents in those places and that the contracts for sale were effected in those places.

There was also a big difference between the purchase and the sale of the products. The purchasing procedure included the finding and testing of new products and the maintaining of a stock thereof in Hong Kong but this was all done by A Limited as an independent party. However in regard to the sales it was necessary to have sales information and materials which were produced by the Taxpayer itself in Hong Kong.

In reality the Taxpayer itself did little either to purchase or sell the products. It used extensively the services of independent agents. When the Taxpayer received orders it passed them on to its subsidiary via computer generated invoices and

collected payment from its customers. Shipment was handled by A Limited, in the name of the Taxpayer. There was clear evidence that the bulk of the staff required were employed by A Limited and that the Taxpayer itself had few employees in Hong Kong.

In his determination, the Commissioner referred to his Departmental Interpretation & Practice Notes No 21:

> 'Where either the contract of purchase or the contract of sale is effected in Hong Kong, the profits will be fully taxable.'

He then went on to say:

> 'I think the latter proposition must follow inevitably from the Privy Council decision in TVBI.'

Counsel for the Taxpayer took issue with this statement of the Commissioner. He said, inter alia, (the emphasis was that of counsel):

> 'The CIR was quite wrong to state that *"the latter proposition must follow inevitably from the Privy Council decision in TVBI":* page 15 § 3(4).
>
> The proposition is not supported by any authority at all, certainly not the TVBI case. If applied it could result in profits being considered to arise in Hong Kong in situations where the actual Hong Kong contributions to any profit were relatively unimportant.
>
> It is true that in TVBI Lord Jauncey commented, *obiter,* at page 446H:
>
> *"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 IRO. Counsel were able to refer to three cases only in which the source of profits had been held not to be in the principal place of the taxpayer:*
>
> *(i) CIT, Bombay Presidency and Aden v Chunilal B Mehta of Bombay [1938] LR 65 Ind App 332*
>
> *(ii) CIR v HK & Whampoa Dock Co [1960] 1 HKTC 85*
>
> *(iii) CIR v Hang Seng Bank [1991] 1 AC 306"*
>
> But he went on at page 447 H:
>
> *"It is clear from the Hang Seng Bank case 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."*

Moreover, given the potentially wide number of cases which could fall within the principles established by those three cases, the use of the word "**rare**" in this *dictum* should not be interpreted too restrictively.

That is putting the matter diplomatically. Being more blunt about it, it has to be said that the observation was factually incorrect: see the comment of the Board of Review in D59/92, IRBRD, vol 8, 63 at page 71.

The "fallacy" came about because the point about "the number of cases" only arose in argument before the Privy Council during the reply by counsel for the Commissioner, Mr Kentridge, and counsel for the taxpayer did not have the opportunity of referring to the numerous case which had come before the Board of Review and before other Commonwealth courts.'

For his part, Mr Chan for the Commissioner in reply quoted that Mr Kentridge had said 'There have only been three cases in which the courts ...' and he emphasised the words 'the courts'. He said that it was unfortunate that Lord Jauncey had omitted the words 'the courts' in his judgment. Mr Chan went on to say that Mr Kentridge was answering a question from the Privy Council. Mr Chan said:

> 'I have in fact asked those instructing me and the Commissioner as to whether it is correct to say there have only been three cases in the court and my understanding is that there are four, so there is one more. It is also confirmed by the book I read on the source of profits. It refers to four cases in the court throughout the past years. Of course I suspect there are hundreds if not thousands of cases in the Board of Review.'

Mr Chan then went on to say that the Privy Council, by omitting the words 'the courts', gives rise to a misleading picture that there have only been three cases. He said 'obviously there are more than three cases but in the terms of cases in the court, it is correct or substantially correct.'

We note that the Law Report of the TVBI case when reporting what Kentridge QC said in reply at page 403 reads as follows:

> *'There have been only three cases in which the courts have held the source of profits not to be where the taxpayer had his main place of business: Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306; Commissioner of Income Tax, Bombay Presidency and Aden v Chunilal B Mehta of Bombay [1938] LR 65 Ind App 332 and Commissioner of Inland Revenue v Hong Kong & Whampoa Dock Co Ltd 1196011 HKTC 85. Each of those cases, unlike the present one, related to a clearly separate profit-earning operation carried on abroad.'*

As we disagree with the Commissioner's Departmental Interpretation and Practice Notes No 21 we consider it appropriate to set in full what Lord Jauncey said in his judgment:

'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 IRO. Counsel for the Commissioner was able to refer to three cases only in which the source of profits had been held not to be in the principal place of business of the taxpayer. In Commissioner of Income Tax, Bombay Presidency and Aden v Chunilal B Mehta of Bombay [1938] LR 65 Ind App 332 a broker in Bombay entered into future delivery contracts for the purchase and sale of commodities in various foreign markets with parties outside British India, in which no delivery was ever given or taken, and the profits flowing from such contracts were not received in British India. This Board held that in the particular circumstances - the contracts having been neither framed nor carried out in British India - the profits derived from the contracts did not there accrue or arise. The circumstances were thus very similar to those obtaining in the Hang Seng Bank case [1991] 1 AC 306. In CIR v Hong Kong & Whampoa Dock Co Ltd [1960] 1 HKTC 85 the appellants, in response to a request from the owners, sent a tug to salvage a vessel stranded on a foreign island. The tug refloated the vessel, towed her to a sheltered anchorage where she was made fit for the tow to Hong Kong, and thereafter towed her for four days to docks in Hong Kong. The Supreme Court (Appellate Jurisdiction) held that the profits from the salvage operation were not "profits arising in or derived from the colony" within the meaning of section 14(1) of the IRO. Reece J said, at page 116:

"Here the contract of salvage was entered into in the Paracels and all the work of refloating and putting the vessel into a condition to be towed to Hong Kong and nearly all the tow, except for the last three miles, were completed beyond the territorial limits of Hong Kong and consequently I take the view that the profits must be said to arise outside of the Hong Kong rather than inside."

The third case is the Hang Seng Bank case.'

We reject the statement made by the Commissioner in his Practice Note and the supporting suggestion made by Mr Warren Chan QC that any trader who either buys or sells in Hong Kong will be liable to be assessed to profits tax on any resulting profit. If that were the law then it would be impossible to understand why so many learned judges have spent so long analyzing the position when all they had to do was to make a simple one sentence statement which would have been clear and authoritative. If that were the law it would be simple for the Legislature to so say in the IRO. It may be that the purchase of something in Hong Kong will be the source of profit and it may be that the sale of something in Hong Kong may be the source of profit but each case will depend upon its own facts. Every trading transaction must have both a purchase and a sale. If one takes place in Hong Kong and one takes place outside of Hong Kong and both locations had a similar territorial tax system then on the Commissioner's interpretation of the law, the profit would arise in both places. In our opinion that is not the law.

Having rejected this part of the Commissioner's case, we now consider what it is that we have to decide. What was the source of the profit which the Commissioner is seeking to tax? What was it that the Taxpayer did to earn that profit? The second question is to find out where the source was located. Where did the Taxpayer do what it did to earn that profit? First we look at what the Taxpayer did to earn the profit. This is a case of a trading profit and the purchase and the sale are the important factors. We place on record that we have included in our deliberations all of the relevant facts and not just the purchase and sale of the products. Clearly everything must be weighed by a Board when reaching its factual decision as to the true source of the profit. We must look at the totality of the facts and find out what the Taxpayer did to earn the profit.

Counsel for the Taxpayer naturally placed great emphasis on the selling of the products and emphasised that all selling activities and the actual sales took place outside of Hong Kong. He placed little emphasis on the procurement and actual purchase of the products.

Counsel for the Commissioner submitted that the converse was the case. He emphasised the importance to the Taxpayer of having to acquire the goods before being able to sell them. He referred to the accounts of the Taxpayer and drew attention to the substantial money paid by way of commission or fees to A limited for the services which it provided to the Taxpayer for sourcing and purchasing the goods.

At the beginning of the hearing counsel for the Commissioner had sought to challenge that the sales of the products had taken place outside of Hong Kong. He cross-examined the first witness on an inconsistency appearing on the face of one of the specimen documents which had been produced by the Taxpayer. However as it was clear from the evidence of the witness that the export managers had power to and did bind the Taxpayer, counsel did not pursue this line of argument further and accepted that the purchase took place in Hong Kong and the sale took place outside of Hong Kong. Counsel for the Taxpayer accepted that the purchase of the products had taken place inside of Hong Kong.

Counsel for the Taxpayer took issue with the importance placed on the purchase by pointing out that the Taxpayer had offered three witnesses for cross-examination as to the purchasing of the products and suggested that the Commissioner had failed to take advantage of the opportunity offered to him. This raises an interesting point as to the meaning of the onus of proof in tax cases. We have set out in some detail as facts found by us the evidence given by the three witnesses. The two directors of the Taxpayer dealt with the purchasing of the products in their evidence in chief and explained what the Taxpayer did itself and what A Limited did. More time was spent by the witnesses emphasising what was done to effect sales rather than purchases. However it can hardly be said that the Taxpayer did not cover the purchase side of its business. The Commissioner chose neither to cross-examine nor to lead evidence of his own on this important point. He relied on the accounts which showed how much the Taxpayer paid to A Limited for what it did and the evidence in chief of the witnesses. Though more evidence on this point might have helped the Board to understand exactly what was done

in Hong Kong it is not something which is of great concern to us because there is sufficient evidence before us on which to reach a considered decision.

Having carefully considered the case it was the view of the Board that as a matter of fact the operations from which the profit arose took place outside of Hong Kong. The profit arose from the selling operations of the Taxpayer rather than from its purchase of the products or anything else which it did in Hong Kong. Mr Chan for the Commissioner referred to the 'services' provided by A Limited and A Limited being remunerated by the Taxpayer for its services but A Limited was not acting as an agent for the Taxpayer. It was an independent trader which saw an opportunity to make a profit for itself. It set up business to supply products to the Taxpayer on an exclusive basis. We are not here asked to decide what tax A Limited should pay nor to assess the Taxpayer for profits which A Limited did or should have made. The Taxpayer paid fees or commission to A Limited but on the evidence before us A Limited was not the agent of the Taxpayer. What A Limited did was just part of its trading business. Many manufacturers and traders can have exclusive arrangements with customers for the stocking and supply of products.

One member of the Board was particularly concerned regarding the position of the Taxpayer with regard to its distributors if the independent export managers could really bind the Taxpayer without reference to the Taxpayer. What would happen if there were a very large order, or a very short delivery time, or the supply of the particular product was temporarily interrupted? The evidence before us is quite clear. The export managers had such power, and it seems that there was no such problem in practice. This again demonstrates the importance of selling to the business of the Taxpayer. The evidence before us is to the effect that the supply of the products was not a problem for the Taxpayer.

We gave careful consideration to the warehousing and repacking and labelling done in Hong Kong. Here again we find that it was not the Taxpayer, itself or through an agent, which performed this function. It was A Limited which did this for its own account. This was the business of A Limited and not the Taxpayer.

We have considered all of the things which the Taxpayer did apart from the purchase and the sale. However in the case before us it is the sale and purchase elements of the trading transaction which are really material. Everything else was ancillary. Indeed even if the Taxpayer itself had warehoused, labelled and re-packaged products and not A Limited we would not have found such activities to be the source of the profits.

It appeared to this Board quite clear on the facts before it that when the purchase of the products was balanced against the sale, the latter was by far the most important and was the source from which the profit arose. The sales took place outside of Hong Kong and though certain activities took place in Hong Kong, like invoicing, shipping, collecting payment etc, they were ancillary and not the true source of the profit.

Before the Board had delivered its decision an important development took place which was the judgment delivered by Mr Justice Barnett on 17 January 1995 in CIR v Euro Tech (Far East) Limited Inland Revenue Appeal No 2 of 1994, unreported at the

date of this decision. That judgment is subsequent to both of the relevant Privy Counsel cases. It deals specifically with trading cases and it appeared to this Board that the facts, though different, might have a bearing on the case before us. It also states that the Board should have considered the Exxon case (Exxon Chemical International Supply SA v CIR 3 HKTC 57), a case which was not argued before us by counsel in their original submissions. It is apparent from what Mr Justice Barnett says that in his opinion the Board in the Euro Tech case misread the facts and also the law. The Board in the Euro Tech case was chaired by the same chairman as the appeal now before us. In the Euro Tech case the Board did not have the benefit of legal submissions. To avoid any possible such errors arising in this appeal the Board thought it necessary to reconvene to enable counsel for the respective parties to address it on the Euro Tech judgment.

Before counsel re-appeared, the Board outlined a number of concerns which it had following the Euro Tech judgment. These fell into two broad categories, one relating to comments made by Mr Justice Barnett relating to the facts and the other to the law.

The High Court has no jurisdiction to re-hear a tax appeal. It only has jurisdiction to hear questions of law. The High Court can only interfere with findings of fact if the tribunal has been perverse, that is, it has reached a finding of fact which no tribunal could have found on the evidence if it had been properly directed. It is in that context which we read the following statement of Mr Justice Barnett:

> *'The documents … show a trading company receiving orders from its distributors, confirming those orders and issuing proper invoices, placing complementary orders, or "confirmatory" as the Board puts it, with the appropriate company in the UK, calling for shipping documents such as an airway bill to be sent to it, and making proper and necessary financial arrangements. The Taxpayer was, and presumably still is a trading concern of like nature to the many (sic) trading concerns in Hong Kong that rely for their existence and profit upon the ability to sell goods for a price greater than that at which they acquired them.*
>
> *... Further, as a matter of commercial reality and practical common sense, the Taxpayer would hardly accept an order from one of its distributors if, in so doing, it was because of time constraints or the shear size of the order laying itself open to breach of contract and the perhaps serious consequences thereof. Quite plainly, someone in the Taxpayer's officer (sic) must have been scrutinizing incoming orders and determining whether or not they could be fulfilled in the terms in which they were placed. Further the terms of the distributor agreements themselves might in certain cases call for discussion about the discount to be given to the distributors.'*

We have a similar situation in the case before us. We have found as a fact that the export managers had the power to bind the Taxpayer by selling products overseas. We know from the evidence how they performed this function. They did not refer back to Hong Kong before binding the Taxpayer. As in the Euro Tech case, there must have been the risk of breach of contract suits. Indeed the position was worse. In the Euro Tech

case the distributor placed orders through the wholly owned Hong Kong subsidiary on the parent group in the United Kingdom. In the case before us agents in the field had specific power to bind the Taxpayer which relied on its subsidiary to hold stocks in Hong Kong and when necessary had to have products made in USA and then shipped to Hong Kong before onward shipment to distributors. Whilst in our opinion, and no doubt the opinion of the Board in the Euro Tech case, a distributor would think twice before making a contractual claim in such circumstances because to do so would inevitably lead to a termination in the relationship, it is obviously possible. The question which raised itself was whether we can find as a fact on the clear evidence before us and which we have accepted something different to the Euro Tech case.

With regard to the law as stated in the Euro Tech case we have concern regarding two matters.

The Euro Tech case expressly directs us to consider the Exxon case:

'During the course of argument, the Board was referred to Exxon Chemical International Supply SA v CIR 3 HKTC57. However apart from noting the Commissioner's argument based on this case, the Board did not make any reference to it. This case involves a decision of Godfrey J in 1989. The facts bear a very considerable similarity to the facts in the present case. Exxon was the wholly owned subsidiary of a multi-national corporation in USA. It carried on business in Hong Kong and the Bahamas. In the course of business in Hong Kong, it purchased goods from one affiliate within the group and sold them to another. At page 100 the judge said:

> *"ECIS submits that before deciding where a profit is derived (or, I suppose, where it arises) it is necessary first to determine how the profit is derived and then (and then only) secondly to determine where it is derived. I am content for the purposes of the present case to accept this; having already demonstrated how the profit on the transaction in question was derived from a "mark-up" on sales (as ECIS itself submitted) and I can go on to consider where it was derived. I ask myself: Where did ECIS obtain the buyer's order for the goods? The answer is that it obtained that order in Hong Kong. I ask myself: Where did ECIS place its order with the seller for the goods to meet the buyer's requirements? The answer is that it placed that order from Hong Kong. These acts, the obtaining of the buyer's order in Hong Kong and the placing of the order with the seller from Hong Kong, are the foundations of the transaction; for it is the differential between the selling price and the buying price ("the mark-up") which generates, indeed represents, the profit.*
>
> *Having decided that the obtaining of the order from the buyer, and the placing of the order with the seller, took place respectively in and from Hong Kong, I conclude that the profit made by ECIS on this transaction arose in, or is derived from, Hong Kong. That is where ECIS transacted this piece of business; and the profit it earned from*

> *it was earned by what it did here. It may not be much that ECIS did to earn its profit; but as a hard, practical matter of fact, it was here that it did it."*

Interestingly, in that passage is foreshadowed the principle now laid down in the 2 leading cases. Having dealt with what Exxon did to make its profit, the judge then proceeded at page 102 to deal with where the profit was made.

> *"In my judgment (and on this I agree with the Board), on the facts ECIS derived its profits from what it did in Hong Kong. The income which arose from the "mark-up" taken by ECIS arose where the mark-up was taken; that is to say, in Hong Kong. No doubt, income arose on the sale by the seller to ECIS; but that was income of the seller. No doubt, income arose on the delivery of the goods to the buyer; but that was the income of those responsible for getting the goods from Houston to Singapore. The only income of ECIS was its "turn" between the selling and buying prices. ECIS does not operate, outside Hong Kong, any activity with a view of profit. It is in my view immaterial that the subject of the transaction, effected in this case by the acceptance by ECIS of the order from the buyer, and matched (at a profit) by its own order placed with the seller, was a load of lube oil additive destined for transhipment from the USA to Singapore. The business was transacted in Hong Kong."*

That case was cited in the Hang Seng Bank case and did not attract any criticism. For my part, I agree with the analysis of Godfrey J. It seems to me a great pity that the Board did not take time to reflect upon and, if they thought appropriate, distinguish the case. For my part, I find the case indistinguishable. Like Exxon and so many other trading companies, the Taxpayer was doing no more than bringing together the complementary needs of sellers and buyers, and that bringing together it did in Hong Kong. Despite the concerns expressed by the Board about the attitude of tax authorities in other countries, it is quite plain that the profit in this case arose from operations carried on in Hong Kong.'

The second legal matter raised by Mr Justice Barnett is as follows:

'It is fair to say that neither the Commissioner nor the Taxpayer were legally represented before the Board. Indeed, the Taxpayer was not represented at all before me other than by a finance director (which alone suggests that the Taxpayer is something more than a mere postbox). For that reason, perhaps, the Board may have been misled into believing that the Commissioner wished to put a far wider meaning on the principle which I have set out than is warranted by the decisions in the two cases.

Alternatively, the Board simply did not grasp the import of the cases themselves. At all events, a terrible misunderstanding seems to have occurred because the Board in the case stated said this:

> "It is quite apparent from this case, the Hang Seng Bank case, and the TVB case, that the Commissioner of Inland Revenue is seeking to give section 14 a much wider meaning than hitherto. The so called "operations test" has become of paramount importance. The question which the Commissioner seeks us to answer is "where did the operations of the Taxpayer take place". Obviously the operations of the Taxpayer took place in Hong Kong. Hong Kong is the only place where the Taxpayer had its operations. It did not have any branch or office outside of Hong Kong. If that is to be the test then we have gone a long way away from asking the average person in the street where he would see profits arising. The "hard practical matter of fact" test of Lord Atkin and the many previous decision based on it would have little relevance any more. It also takes us perilously close to taxing in Hong Kong profits which other countries might think should be properly taxed within their own territory. In the present case one cannot help but think and feel that the United Kingdom and Korean tax authorities might, with some justification, feel that whatever profit there is in the present transaction arises either from the efforts of those in the United Kingdom or Korea and has little or nothing to do with Hong Kong. It is totally irrelevant that the Taxpayer for one reason or another may not pay tax in the United Kingdom or Korea."

I was assured by counsel who now represents the Commissioner, that the Commissioner was not advocating some wide general approach to a taxpayer's operations. The Commissioner was simply adopting a short hand way of getting over the principle laid down in the 2 leading cases. He was simply seeking to ask "what operations gave rise to the profit and where did those operations take place?"

The Board next went on to say that it found great difficulty in rationalizing the decisions in these 2 cases. I have to say that I am at a loss to find where this difficulty arises. The principle enunciated by Lord Bridge was picked up and elaborated by Lord Jauncey. How that principle was to be applied in the later case depended, of course, upon the particular facts of that case. The principle itself remained unaffected. The Board then said:

> '(vii) We find great difficulty with the Privy Council decision in the TVB case because it is not only founded on a fallacy but also if applied generally would mean that Hong Kong would have to have a series of worldwide tax treaties and would not longer be safe haven for the operations of multi-national groups of companies.
>
> (viii) The fallacy is that stated by Lord Jauncey at page 9 of the unreported decision where he says:

> "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 IRO. Counsel for the Commissioner was able to refer to three cases only in which the source of profits had been held not to be in the principal place of business of the Taxpayer."

(ix) This is a surprising statement if counsel for the Commissioner was properly instructed on the point because there must be many hundreds, if not thousands, of cases on record in the Inland Revenue Department where the Commissioner has agreed with the Taxpayer that the Taxpayer who has a principal place of business in Hong Kong has earned profits outside of Hong Kong which are not subject to the charge to tax in section 14 of the IRO.

(x) If every person with a principal place of business in Hong Kong is subject to profits tax on all of the profits of that principal place of business save and except the exceptions to which Lord Jauncey refers then there will be many cases where persons who have a principal place of business in Hong Kong will be subject to double taxation. The three exceptions mentioned by Lord Jauncey were the unique case of a ship repair company which maintains a salvage tug boat and two cases relating to the trading of securities outside of Hong Kong. Lord Jauncey does not appear to understand the international nature and flavour of the business transacted through Hong Kong."

The Board itself is, I am afraid, guilty of a fallacy. The words emphasised in the passage quoted from Lord Jauncey do not in fact appear in the law reports. The actual words were "Counsel were able" which confirms what I was told from the bar namely, that they reflected the researches of counsel on both sides. I was also informed from the bar, on instructions, that the Commissioner commonly agrees that profits are not chargeable to tax if they fall into one of 3 categories namely, (1) interest on deposits outside Hong Kong, (2) provision of a service or services outside Hong Kong or (3) the development of land outside Hong Kong.

It seems to me that Lord Jauncey was doing no more than state what is a common sense. If a taxpayer has a principal place of business in Hong Kong, it is likely that it is in Hong Kong that he earns his profits. It will be difficult for such taxpayer to demonstrate that the profits were earned outside Hong Kong and therefore not chargeable to tax.'

Counsel for both the Taxpayer and the Commissioner in their opening submissions before the Euro Tech judgment was delivered had already addressed the

Board about Lord Jauncey's statement in words very different to those of Mr Justice Barnett.

It is not for this Board to try to resolve the conflict between the statements made to it by counsel and what Mr Justice Barnett has said. That we leave for higher authority to resolve. Likewise it is not for this Board to resolve the wording of the Law Report before Mr Justice Barnett. However what does concern this Board are the statements made by the Privy Council and Mr Justice Barnett that the ambit of the words 'arising in or derived from Hong Kong' appearing in section 14 of the IRO are to have very limited application. On the one hand we are told to look at what the Taxpayer did to earn the profit and then at where it was done. On the other hand we are told in the clearest words that when considering this it will be rare that anyone carrying on business in Hong Kong without a permanent establishment overseas will not pay tax on all of the profits of that business. The exceptions stated by Lord Jauncey were effectively two namely the offshore trading in marketable securities, shares and financial instruments or the performing of services offshore. Mr Justice Barnett has given his version of the law by further limiting exceptions to land development offshore (but apparently not trading or leasing of overseas properties), performing services offshore and earning interest offshore. Neither make any reference to trading in goods and products. The two cases go to the very heart of the matter. In the judgements in both, ordinary trading cases do not fall in a category where profits can readily be held to be offshore and not taxable. The appeal before us does not involve interest on deposits, nor the provision of services outside of Hong Kong nor the development of land outside of Hong Kong nor trading in securities, financial instruments and similar paper assets. It involves trading in products. In the words of Mr Justice Barnett 'the Taxpayer was doing no more than bringing together the complementary needs of sellers and buyers.'

When he re-appeared before the Board, Mr Warren Chan, QC, for the Commissioner made the following submission on the Euro Tech case. He said that the Euro Tech case confirms the Hang Seng Bank case and the TVBI case. He said that the Euro Tech case is an illustration of the application of the law as set out in Hang Seng Bank and TVBI cases. With regard to the Exxon case he drew attention to the fact that the Exxon case antedated the later Privy Council cases and said that the hearing would be much longer if counsel were to refer to all relevant cases. He considered the principle to be now clearly stated in the Hang Seng Bank and TVBI cases. He summarise the Commissioner's case in the following words:

> 'Applying the applicable law, as is illustrated by Euro Tech, to the facts of this case, there can only be one reasonable conclusion, that is, the profits of the Taxpayer arose from operations carried on in Hong Kong.
>
> (a) The Taxpayer purchased goods, in Hong Kong, from A Limited.
>
> (b) The Taxpayer sold goods to distributors. The goods were shipped from Hong Kong by the Taxpayer to the buyers.

> On the facts of the Taxpayer's case, any reasonably-minded tribunal, properly directed as to the law, would have come to the conclusion that the profits of the Taxpayer arose from operations carried on in Hong Kong.'

Mr Huggins, QC, for the Taxpayer said that there was unchallenged evidence before the Board that the export manager had authority to effect sales on behalf of the Taxpayer and to bind the Taxpayer. He said that it was open to the Board to accept the truth of what they were told by the witnesses. He said that the Euro Tech case did not mean that the Board must reject the evidence of the witnesses. He cast doubt on what Barnett J had said in the Euro Tech case but said that it was not material to the present case.

With regard to the statement by Barnett J relating to a finance director being in Hong Kong he said that whatever the learned judge may have meant he could not mean that because a company has a director in Hong Kong that this is a material pointer to the source and location of profits. The Hang Seng Bank case clearly showed that the opposite was the case.

He said that it was not necessary for the Board to analyze carefully and in detail the facts of either the Euro Tech case or the Exxon case. Each case must depend upon its own facts. He said that it is not helpful for the Board to feel under any compunction to analyze expressly in its determination or other cases where similar issues have been raised and which have either been cited to the Board by counsel or of which it is aware even if not cited by counsel.

Mr Huggins referred to what he called 'the rare case dictum' of Lord Jauncey in the TVBI case and the comments of Barnett J with regard thereto. Counsel said that it was simply not correct to suggest that there had been so few decided cases in which profit had been held to arise elsewhere than where the Taxpayer carried on its business. He cited, by way of example, seven Australian tax cases and said that there were a vast number of other cases.

As we have said above this Board finds itself in a difficult position. Having heard the evidence, having carefully considered the submissions by the two leading counsel, and having duly deliberated this Board was of the opinion that the operations from which the profit arose took place outside of Hong Kong. We have now given the matter further consideration in the light of the Euro Tech case and in the light of the further submissions made by the two leading counsel and we have come to the conclusion, with some trepidation, that our original view of the case is correct.

We distinguish this case from the Euro Tech case on its facts. In the Euro Tech case the Board and the learned judge came to completely different views as to what were the facts. The Board drew one set of conclusions from the evidence and the learned judge another. The learned judge felt that no reasonable Board could have come to the conclusions which it did on the evidence. That is not, we would hope the situation in this case. In the Euro Tech case no oral evidence was called before the Board and the matter was decided purely on documentary evidence. The Board as a fact finding tribunal were of the opinion that Euro Tech as a subsidiary of a United Kingdom public company had

done little in Hong Kong. The learned judge has said that was not a finding of fact that was open to the Board on the evidence before it. In this case we have the benefit of extensive oral evidence all of which we have accepted as being the truth.

Having been directed to consider the Exxon case we have done so and also distinguish that case on its facts. That was a case similar to Euro Tech in that it related to the subsidiary in Hong Kong of a large multi-national corporation. The parent set up a subsidiary in Hong Kong for the purpose of distributing its products in the region. Neither Euro Tech nor the subsidiary of Exxon had their own sales organisations or operations outside of Hong Kong. The Taxpayer before us had an important sales organisation or operation outside of Hong Kong in the form of its export managers. The case now before us is far removed from the facts of the Exxon case.

In the case before us we agree that the two important matters to consider are the purchase and the sale. We have carefully weighed up the one against the other and decided as a matter of fact that in our opinion and judgment the source of the profit was the sale. The Taxpayer had available to it in Hong Kong a ready source and supply of products. The Taxpayer is a separate entity from A Limited. A Limited was not the agent for the Taxpayer. A Limited ran its own business, separate and independent from the Taxpayer. Its business was to supply the Taxpayer with whatever products the Taxpayer required. It was Mr Chan for the Commissioner who stressed how much money the Taxpayer had to pay to its subsidiary for the service which the subsidiary provided. This was not the business of the Taxpayer. So far as the Taxpayer was concerned the purchase of the products was not even a phone call away. A computer was able to handle this part of its business.

When we come to look at the sales the picture is completely different. The sales were clearly more important. These were also largely delegated to third parties who were separate persons from the Taxpayer but when performing their services they did so in the name of and on behalf of the Taxpayer. Sales contracts were in the name of the Taxpayer. What the export managers did they did as agents for the Taxpayer. They promoted the sales of the products of the Taxpayer not as independent agents acting independently of the Taxpayer but as its direct agents. The distributors and not the export managers were the equivalent of A Limited on the sales side of the transactions. The Taxpayer attributed its success and therefore its profits to its export managers. Without doing what they did to promote and sell the products the business of the Taxpayer would not have been successful. What they did was done as direct agents of the Taxpayer. It is the same as if the Taxpayer had done the things itself. Without the activities of the export managers there would have been no sales, no purchases no business and no profits. As a matter of fact we find that the profits which the Commissioner is seeking to tax arose from what the export managers did and that the export managers were acting as agents of the Taxpayer.

Having decided what the Taxpayer did to earn the profit in question we now must look at where it was done. On the facts before us this is an easy question to answer. It was done outside of Hong Kong. The evidence before us clearly shows that the export managers did everything in their own territories outside of Hong Kong. Some sales did

take place in Hong Kong but these have already been offered for assessment to profits tax and are not the subject matter of this appeal.

We have given further thought to whether the Commissioner is right in saying that anyone who either buys or sells in Hong Kong will have to pay profits tax on all of their profits. Neither Lord Jauncey nor Mr Justice Barnett were prepared to go that far. If that were the law then they could and no doubt would have said so. What in fact they said is that we should do what we have done in this case.

For the reasons given we allow this appeal and direct that the assessments against which the Taxpayer has appealed be referred back to the Commissioner to reduce the amount of assessable profits and tax thereon accordingly with liberty to the parties to make application to this Board in the event of their not being able to agree the amounts.