Case No. D13/13

Case stated – application for case stated – proper question of law – section 69(1) of the Inland Revenue Ordinance.

Panel: Kenneth Kwok Hing Wai SC (chairman), Fu Mee Yuk Shirley and Vincent P C Kwan.

Date of hearing: Stated case, no hearing.
Date of decision: 29 July 2013.

By its decision dated 6 December 2011 ('the Decision'), the Board dismissed the Appellant's appeal. The Appellant made an application requiring the Board to state a case on 4 proposed questions of law for the opinion of the Court of First Instance.

Held:

1. All of the proposed questions are not proper questions of law. The Board declines to state a case and dismisses the Appellant's application for a case stated.

2. An objection common to all of the proposed questions is the inclusion of the 'and the material before the Board'. It is wholly impermissible to go beating about the evidential undergrowth in the hope of flushing out some useful pieces of evidence that support an applicant's view, in total disregard of settled law that the Board's findings of primary fact, in so far as there is any evidence to support them, are sacrosanct. If the Appellant wishes to contend that the Board should have made further findings, it should have included a question on the findings which the Appellant contends the Board should have made so as to enable the Board to decide on the evidence which the Board should marshal in stating the case.

3. Another objection common to Questions 1 and 3 is that the correct question is not whether 'the Board was correct in law to conclude' but 'whether it was open to the Board' to conclude (see paragraphs 1 – 5 and 44 in the Court of Final Appeal's judgment in Lee Yee Shing and another v CIR (2008) 11 HKCFAR 6 and Kim Eng Securities (Hong Kong) Ltd v CIR (2007) 10 HKCFAR 213 at paragraph 55, quoting Kwong Mile Services Ltd v CIR (2004) 7 HKCFAR 275 at paragraph 288D-E and 291J-292B and Edwards (Inspector of Taxes) v Bairstow & Another [1956] AC 14 at page 36).

4. Apart from the above, the proposed questions are rejected for the following reasons:

   (1) In respect of Question 4, the decision whether to grant or refuse an adjournment is a matter of managing and regulating the proceedings before the Board and lies within the discretion of the Board (So Kai Tong Stanley v CIR [2004] 2 HKLRD 416). The court is slow to interfere with such decisions, though it may interfere when it is shown that an injustice had occurred. The source issue is a matter which the Appellant bore the burden of proof and the Appellant should have on its own volition and as part of its case to muster evidence to discharge its burden. It is not the Appellant's case that no person acting judicially and properly instructed as to the relevant law could have exercised the Board's case management discretion in the way it did. The Appellant's argument on adjournment has no prospect of success.

   (2) Question 1 does not arise from the Decision.

   (3) Question 2 is a clear attempt to usurp the fact finding function of the Board and does not have factual basis.

   (4) Question 3 raises new issues which were not argued before the Board.

Application dismissed.

Cases referred to:

CIR v HK-TVB International Limited [1992] 2 AC 397
Commissioner of Inland Revenue v Inland Revenue Board of Review and another, [1989] 2 HKLR 40
Commissioner of Inland Revenue v Inland Revenue Board of Review and Aspiration Land Investment Ltd (1989) 3 HKTC 223
Commissioner of Inland Revenue v Aspiration Land Investment Ltd [1991] 1 HKLR 409
So Kai Tong Stanley v CIR [2004] 2 HKLRD 416
Same Fast Limited v Inland Revenue Board of Review, (2007-08) IRBRD, vol 22, 321
Honorcan Ltd v The Inland Revenue Board of Review [2010] 5 HKLRD 378
Tungtex Trading Co Ltd v Commissioner of Inland Revenue [2012] 2 HKLRD 456
Lee Yee Shing and another v CIR (2008) 11 HKCFAR 6
Kim Eng Securities (Hong Kong) Ltd v CIR (2007) 10 HKCFAR 213
Kwong Mile Services Ltd v CIR (2004) 7 HKCFAR 275

Edwards (Inspector of Taxes) v Bairstow & Another [1956] AC 14
A Solicitor v The Law Society of Hong Kong, CACV 60/2012

Decision:

Introduction

1. All references to sections and subsections are to those of the Inland Revenue Ordinance, Chapter 112 ('the Ordinance').

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2. Messrs Deloitte Touche Tohmatsu ('Deloitte') have since the Taxpayer's incorporation on 5 February 1991 until it became dormant in February 2002 been the Taxpayer's auditors and have at all material times been the Taxpayer's tax representatives.

3. The Taxpayer appealed to the Board of Review ('the Board') against the profits tax assessments for the years of assessment 1999/2000 to 2002/03.

4. The assessments appealed against were all dated 15 March 2006. By letter dated 18 April 2006, Deloitte objected to the assessments on behalf of the Taxpayer.

5. By his Determination dated 16 December 2009 ('the Determination'), the Acting Deputy Commissioner of Inland Revenue confirmed all the assessments objected to.

6. By letter dated 15 January 2010, Messrs Baker and McKenzie gave notice of appeal on behalf of the Taxpayer from the Determination.

7. The grounds of appeal contained in the notice of appeal read as follows:

> ' (i) The [Taxpayer] did not carry on a "trade, profession or business" in Hong Kong within the meaning of the IRO during the years in dispute.
>
> (ii) Assuming, which is not the case, that the [Taxpayer] did carry on business in Hong Kong, such profits as were earned by the [Taxpayer] did not "arise in" or "derive from" Hong Kong within the meaning of the IRO during the years in dispute.
>
> (iii) Assuming, which is not the case, that the [Taxpayer] did carry on business in Hong Kong and did derive some profits from Hong Kong within the meaning of the IRO during the years in dispute, the amount of such profit is substantially less than the amount assessed by the Deputy Commissioner.

(iv) The Deputy Commissioner has failed to respect the spirit or letter of the Departmental Interpretation and Practice Note No. 21 and has therefore prejudiced the [Taxpayer] and other taxpayers acting in reliance upon such Departmental Interpretation and Practice Notes.

(v) The revised statement of loss and the additional assessments are incorrect, and there is no other basis in the IRO that supports the revised statement of loss and the assessments.'

8. The Taxpayer was represented at the hearing of the appeal to the Board on 30 June 2010 by Mr Philip Wong, a tax partner ('the Accountant') of Deloitte.

9. The Accountant applied for an adjournment which was declined by the Board.

10. The Accountant then argued the appeal without calling any witness. He produced a small bundle comprising 3 documents and 2 old Board decisions.

11. CIR did not call any witness.

Board's decision on applications for adjournment and Board's decision on the Taxpayer's appeal to the Board

12. By its Decision, D38/11, dated 6 December 2011 ('the Decision'), the Board:

(1) *so far as relevant to the applications for adjournment, made findings of fact* (paragraphs 4 – 25 of the Decision);

(2) *gave reasons for declining to adjourn the hearing of the appeal* (paragraphs 26 – 33 of the Decision);

(3) *based on facts in the section 'Facts upon which the Determination was arrived at' agreed by the Taxpayer, made findings of fact* (paragraphs 36 – 49 of the Decision);

(4) *reproduced in paragraph 50 of the Decision the Taxpayer's grounds of appeal to the Board* (paragraph 50 of the Decision);

(5) *set out the relevant provisions of the Ordinance* (paragraphs 51 – 56 of the Decision);

(6) *set out the relevant authorities* (paragraphs 57 – 70 of the Decision);

(7) *noted that the Accountant had made no application to amend any ground of appeal* (paragraph 71 of the Decision);

(8) *dealt with ground (i) of the grounds of appeal which the Board rejected* (paragraphs 72 – 75 of the Decision);

(9) *dealt with ground (ii) of the grounds of appeal which the Board rejected* (paragraphs 76 – 86 of the Decision);

(10) *dealt with ground (iii) of the grounds of appeal which the Board rejected* (paragraphs 87 – 89 of the Decision);

(11) *dealt with ground (iv) of the grounds of appeal which the Board rejected* (paragraphs 90 – 96 of the Decision);

(12) *dealt with ground (v) of the grounds of appeal which the Board rejected* (paragraphs 97 – 98 of the Decision); and

(13) *concluded that the appeal failed; dismissed the appeal and confirmed all the assessments appealed against* (paragraphs 99 – 101 of the Decision).

A copy of the Decision is annexed and marked 'Annexure A' which the Board incorporates by reference.

The Taxpayer's application for a case stated

13. By letter dated 6 January 2012, Messrs Brandt Chan and Partners applied on behalf of the Taxpayer to the Board for a case stated on what they said were questions of law.

14. By letter dated 31 January 2012, the Clerk to the Board wrote to Messrs Brandt Chan and Partners:

- asking the Taxpayer to make submissions on why it is proper for the Court of First Instance to consider the questions identified in their letter and to prepare the draft case;

- asking CIR to comment and make submissions and proposed amendments (if any) of the draft case; and

- asking the Taxpayer to comment on CIR's response.

The Taxpayer's questions

15. Under cover of Messrs Brandt Chan and Partners' letter dated 24 February 2012, the Taxpayer submitted a draft case and written submissions made by Mr Chua Guan-Hock SC on its behalf. The questions ('the Questions') as formulated by the Taxpayer read as follows:

‘ (1) Whether on the facts found and the material before the Board, the Board was correct in law to conclude (at paragraph 79) that manufacturing operations could not be the source of profits (cf CIR v HK-TVB International Limited [1992] 2 AC 397 at 410 F-G); and (at paragraphs 84, 88) that there was “no evidence” of any or any offshore manufacturing by the Taxpayer (“Question 1”).

(2) Whether on the facts found and the material before the Board, the Board erred in law in failing to take any or any sufficient account that:

(a) the Taxpayer was the owner and had possessory rights at all material times of the raw materials, and the finished products in question, before any sale of the finished products; and

(b) what the Taxpayer did or had done to its own assets in (1) above, was the source or an important element in establishing the source of its profits (“Question 2”).

(3) Whether on the facts found and the material before the Board, the Board was correct in law to conclude that the Commissioner of Inland Revenue (‘CIR’) would be acting contrary to its statutory duties or that an estoppel was sought against it (paragraphs 93, 94),whereas:

(a) the Taxpayer had a legitimate and reasonable expectation that the CIR would continue to apply its practice for many years of apportioning the Taxpayer’s profits on a 50:50 basis, under the CIR’s own Departmental Interpretation and Practice Note No. 21; and

(b) the CIR as a public body, had a duty to act consistently and fairly, absent any material change in circumstances (“Question 3”).

(4) Whether on the facts found and the material before the Board, the Board erred in law and in the exercise of its discretion in refusing the Taxpayer’s 1st application for an adjournment to seek oral evidence from the Taxpayer’s former director or officer with personal knowledge of its affairs, thereby:

(a) causing an injustice to the Taxpayer such that the Decision cannot stand;

(b) directly prejudicing the Taxpayer’s ability to discharge its onus of proof under section 68(4) of the Ordinance;

(c) such that the refusal of an adjournment and the inability to call such evidence was unjust, and unreasonable ("Question 4").'

16. Under cover of the Department of Justice's letter dated 23 March 2012, Mr Paul H M Leung made written submissions on behalf of CIR.

17. Under cover of Messrs Brandt Chan and Partners' letter dated 14 April 2012, Mr Chua Guan-Hock SC made written reply submissions for the Taxpayer.

Relevant authorities on stating a case

18. Section 69(1) provides that the Board's decision shall be final:

'*The decision of the Board shall be final*'.

The finality of the Board's decision is subject to the proviso on appeals by way of case stated on a question or questions of law. The proviso reads as follows:

'*Provided that either the appellant or the Commissioner may make an application requiring the Board to state a case on a question of law for the opinion of the Court of First Instance. Such application shall not be entertained unless it is made in writing and delivered to the clerk to the Board, together with a fee of the amount specified in Part II of Schedule 5, within 1 month of the date of the Board's decision. If the decision of the Board shall be notified to the Commissioner or to the appellant in writing, the date of the decision, for the purposes of determining the period within which either of such persons may require a case to be stated, shall be the date of the communication by which the decision is notified to him.*'

19. It is trite law that:

(1) an applicant for a case stated must identify a question of law which is proper for the then High Court, now Court of First Instance, to consider;

(2) the Board is under a statutory duty to state a case in respect of that question of law;

(3) the Board has a power to scrutinise the question of law to ensure that it is one which is proper for the court to consider; and

(4) if the Board is of the view that the point of law is not proper, it may decline to state a case;

per Barnett J in Commissioner of Inland Revenue v Inland Revenue Board of Review and another, [1989] 2 HKLR 40 at paragraph 57 H – J ('the Aspiration Case'). See also

subsequent development of the case in the Court of Appeal in Commissioner of Inland Revenue v Inland Revenue Board of Review and Aspiration Land Investment Ltd (1989) 3 HKTC 223 and before Kaplan J in Commissioner of Inland Revenue v Aspiration Land Investment Ltd [1991] 1 HKLR 409 at paragraph 417 I.

20. It is clear from the Aspiration case that:

(a) It is incumbent on an applicant for a case stated to identify a question of law which is proper for the Court of First Instance to consider. It is not for the Board to frame questions for an applicant. The reason is obvious: the parties know better than anyone else what points they wish to take on the appeal (see the Aspiration case at paragraph 48J). A satisfactory question has to be identified so as to trigger the preparation of the case (at paragraph 47I).

(b) The questions the Court is asked to answer 'should be stated clearly and concisely and care should be taken to ensure that the questions are not wider than is warranted by the facts' (at paragraph 48E).

(c) An applicant for a case stated may not rely on a question of law which is imprecise or ambiguous (at paragraph 50G).

(d) The Board is not to be treated as a mere cipher (at paragraph 54H).

(e) It is wholly impermissible to go beating about the evidential undergrowth in the hope of flushing out some useful pieces of evidence that support an applicant's view, in total disregard of settled law that the Board's findings of primary fact, in so far as there is any evidence to support them, are sacrosanct (at paragraph 58F).

21. In So Kai Tong Stanley v CIR [2004] 2 HKLRD 416, the Board took the view that the question:

> ' *Whether, as a matter of law and in the exercise of its discretion, the Board was correct in refusing the appellant's application for adjournment for the purpose of producing further supporting details to support the nature of each expense for the purpose of the Board's examination and to respond to the questions stated in the schedule of the disputed items of entertaining expenses which was prepared by the Revenue at he direction of the Board.*'

does not involve a question of law fit for the determination by the court and does not agree to include it as a question to be determined by the court. Chu J (as she then was) stated at paragraph 19 that:

> ' *I am in agreement with the Board's view that this is not a question of law fit for determination by the court. The decision whether to grant or refuse an adjournment is a matter of managing and regulating the proceedings before the Board and lies within the discretion of the Board. The court is slow to interfere with such decisions, though it may interfere when it is shown that an injustice had occurred: see Gault v CIR (1990) 63 TC 465 at 475G-I. The appellant says that he had been deprived of a full opportunity to adduce sufficient evidence. As the appellant acknowledges, he bears the burden of showing the items of entertainment expenses claimed are properly allowable expenses. The Board noted that the issue of the nature and details of the items of entertainment expenses had been repeatedly canvassed between the appellant and the Commissioner, and that the appellant should have on his own volition and as part of his case provided the details sought in the schedule prepared by the Commissioner. In my view, the Board is clearly entitled to have regard to these matters and to refuse further adjournment for the appellant to complete the information in the schedule. I do not consider the refusal of an adjournment has caused any injustice.*'

22. In Same Fast Limited v Inland Revenue Board of Review, (2007-08) IRBRD, vol 22, 321 at paragraphs 6 and 9, Reyes J considered the questions in that case prolix, argumentative, not easy to understand and embarrassing as a whole. Simply on account of their wordiness and opacity, those questions did not appear to the learned judge at all appropriate for a case stated and the learned judge upheld the decision of the Board refusing to state a case.

23. The Taxpayer is bound by the grounds of appeal. They restrict the scope of evidence to be adduced before the Board[1]. Unless permitted by the Board under section 66(3), the appeal is confined to the original grounds of appeal[2]:

> ' 9. By its representative, each of the Taxpayers put forward the grounds of appeal that the profits in question "were capital in nature and were not assessable to Profits Tax or alternatively that the assessment was excessive". None of the Taxpayers pursued its alternative ground that the assessments were excessive. That left only one question raised by the grounds of appeal given in accordance with s.66(1). Did the profits in question arise from the sale of capital assets? But at the hearing before us, Mr Patrick Fung SC for the Taxpayers contended that there was an antecedent question. Were the profits in question from the carrying on of a trade, profession or business?
>
> 10. No such question is raised by the Taxpayers' grounds of appeal given in accordance with s.66(1). But Mr Fung contended that the Board is to be treated as having consented under s.66(3) to the Taxpayers relying on a

1 Section 68(7).

2 China Map Limited v CIR (2008) 11 HKCFAR 486 at paragraphs 9 & 10.

> fresh ground which raised such a question. For this contention, Mr Fung relied on an exchange between the Board's chairman and the Taxpayers' counsel (not Mr Fung or his junior Ms Catrina Lam). That exchange took place after the close of the evidence and during final speech. By its nature, such a question is fact-sensitive and its answer inherently dependent on evidence. For a tribunal of fact to entertain such a question after the close of the evidence would be unusual and plainly inappropriate if done without offering the party against whom the question is raised an opportunity to call further evidence. No such opportunity was offered to the Revenue. We do not think that the Board is to be treated as having consented under s.66(3) to the Taxpayers relying on a fresh ground which raised the antecedent question for which Mr Fung now contends. If and whenever s.66(3) consent is sought, it should be sought fairly, squarely and unambiguously. Nothing of that kind occurred in this case.'

24. In Honorcan Ltd v The Inland Revenue Board of Review [2010] 5 HKLRD 378, Fok J (as he then was) held that the Board is required to apply a qualitative assessment to the proposed questions of law and is duty bound to decline to state a case if the question of law proposed to be stated is not a proper one, such as a question which is plainly and obviously unarguable:

> (a) The question here is whether the Board was correct in holding that section 69(1) of the Ordinance required it to apply a qualitative assessment to the proposed questions of law which the applicant sought to have referred to the Court for its opinion and, if so, whether the Board correctly applied the relevant test in reaching the conclusion that the proposed questions of law were not proper ones for the opinion of the Court. (paragraph 34)
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> (b) In my judgment, the Board is duty bound to decline to state a case if the question of law proposed to be stated is not a proper one, as the authorities have consistently held. A question proposed to be stated may, it seems to me, be improper for various reasons, as illustrated in the cases discussed above: it may be irrelevant or premature; it may be academic to the outcome of the appeal; it may be embarrassing; it may be plainly and obviously unarguable. (paragraph 50)
>
> (c) If the Board did not have a duty to decline to state a case where a party sought to require it to state a case on a wholly unarguable question of law, there would inevitably be a risk of frivolous appeals being pursued in the Court of First Instance by way of the case stated procedure. I do not discern any intention in section 69(1) of the Ordinance that this should be the position. (paragraph 53)

25. In Tungtex Trading Co Ltd v Commissioner of Inland Revenue [2012] 2 HKLRD 456, Barma J (as he then was) in a judgment handed down on 26 August 2011 applied Hororcan and held at paragraph 31 that if the Board is satisfied that the argument has no prospect of success, it is not bound to include it amongst the questions that it poses for the consideration of the court.

26. Where a conclusion of the Board is challenged, the correct question is:

- whether it was open to the Board to so conclude; or
- whether the true and only reasonable conclusion contradicts the Board's decision appealed against,

see paragraphs 1 – 5 and 44 in the Court of Final Appeal's judgment in Lee Yee Shing and another v CIR (2008) 11 HKCFAR 6 and Kim Eng Securities (Hong Kong) Ltd v CIR (2007) 10 HKCFAR 213 at paragraph 55, quoting Kwong Mile Services Ltd v CIR (2004) 7 HKCFAR 275 at paragraph 288D-E and 291J-292B and Edwards (Inspector of Taxes) v Bairstow & Another [1956] AC 14 at page 36.

Question 4

> ' Whether on the facts found and the material before the Board, the Board erred in law and in the exercise of its discretion in refusing the Taxpayer's 1st application for an adjournment to seek oral evidence from the Taxpayer's former director or officer with personal knowledge of its affairs, thereby:
>
> (a) causing an injustice to the Taxpayer such that the Decision cannot stand;
>
> (b) directly prejudicing the Taxpayer's ability to discharge its onus of proof under section 68(4) of the Ordinance;
>
> (c) such that the refusal of an adjournment and the inability to call such evidence was unjust, and unreasonable.'

27. Question 4 is indicative of the Taxpayer's lack of merits. The Taxpayer is also not forthcoming in its application.

28. In a different context, in A Solicitor v The Law Society of Hong Kong, CACV 60/2012, 22 March 2013, the Court of Appeal dismissed an application for leave to appeal to the Court of Final Appeal. In that case, questions 2 and 3 were formulated as follows:

> ' (2) whether decisions in disciplinary matters by the Investigating Committee of the Respondent attract the application of the doctrine of res judicata;

> (3) if the answer to (2) is in the affirmative, whether it is unfair for the Respondent to refrain to make discovery of such decisions.'

The Court of Appeal said in paragraph 4 that:

> ' In the written submission of Mr Coleman, SC and Mr Jonathan Wong, who appeared for the Solicitor in this application[3], question (3) was dealt with first. That was the same order Mr Coleman addressed us today. This seems to us to be putting their arguments back to front, and is indicative of the lack of merits in the case advanced for the Solicitor in this application. Question (3), as framed in the Notice of Motion, is premised on question (2) being answered in the affirmative. If this court is not persuaded that leave should be granted for question (2), there is no need to consider question (3) at all.'

29. If the Taxpayer accepts that its appeal is bound to fail in the absence of evidence which it hopes may be forthcoming after an adjournment, then Question 4 should come first and failure on Question 4 will be decisive against the Taxpayer. There is then no need to consider Questions 1 to 3. The Taxpayer should be forthcoming with the Court on whether further evidence is crucial to the success of its appeal.

30. Secondly, as Chu J said in So Kai Tong Stanley[4], the decision whether to grant or refuse an adjournment is a matter of managing and regulating the proceedings before the Board and lies within the discretion of the Board. The court is slow to interfere with such decisions, though it may interfere when it is shown that an injustice had occurred. The source issue is a matter which the Taxpayer bore the burden of proof and the Taxpayer should have on its own volition and as part of its case to muster evidence to discharge its burden.

31. Further, it is not the Taxpayer's case that no person acting judicially and properly instructed as to the relevant law could have exercised the Board's case management discretion in the way it did. In view of the Board's findings of fact and for reasons given by the Board in paragraphs 4 – 33 of the Decision, the Taxpayer's argument on adjournment has no prospect of success in the context of an appeal by way of case stated.

32. The next objection is the inclusion of the words 'and the material before the Board'. It is wholly impermissible to go beating about the evidential undergrowth in the hope of flushing out some useful pieces of evidence that support an applicant's view, in total disregard of settled law that the Board's findings of primary fact, in so far as there is any evidence to support them, are sacrosanct. If the Taxpayer wishes to contend that the Board should have made further findings, it should have included a question on the findings which the Taxpayer contends the Board should have made so as to enable the Board to decide on the evidence which the Board should marshal in stating the case.

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[3] Mr Jonathan Wong argued the appeal before [the Court of Appeal] but not Mr Coleman, SC.

[4] See paragraph 21 above.

33. Question 4 is not a proper question for the Court's opinion.

Question 1

> ' Whether on the facts found and the material before the Board, the Board was correct in law to conclude (at paragraph 79) that manufacturing operations could not be the source of profits (cf CIR v HK-TVB International Limited [1992] 2 AC 397 at 410 F-G); and (at paragraphs 84, 88) that there was "no evidence" of any or any offshore manufacturing by the Taxpayer'.

34. The first objection is the inclusion of the words 'and the material before the Board'. The Board repeats paragraph 32 above.

35. The next objection is that the correct question is not whether 'the Board was correct in law to conclude' but 'whether it was open to the Board' to conclude.

36. The Taxpayer asked whether 'the Board was correct in law to conclude (at paragraph 79) that manufacturing operations could not be the source of profits'. This is not a question which arises from the Decision and is thus not a proper question.

37. The Board did not conclude in paragraph 79 that 'manufacturing operations could not be the source of profits'. The Board did nothing of the sort. What the Board said at paragraph 79 of the Decision was that:

> ' *Manufacturing by itself does not generate any profit. A profit arises if, for example:*
>
> (1) *the appellant manufactured for another party at a fee higher than its costs of manufacture; or*
>
> (2) *the appellant sells goods which it makes at a price above its costs of manufacture.'*

38. Further, if there were any evidence of any or any offshore manufacturing by the Taxpayer, there seems little or no reason for the Taxpayer to have taken the trouble of seeking an adjournment and complaining about the Board's refusal to adjourn. It could simply have drawn the Board's attention to the evidence on offshore manufacturing. The Board repeats paragraph 10 above.

39. Question 1 is not a proper question for the Court's opinion.

Question 2

> ‘ Whether on the facts found and the material before the Board, the Board erred in law in failing to take any or any sufficient account that:
>
> (a) the Taxpayer was the owner and had possessory rights at all material times of the raw materials, and the finished products in question, before any sale of the finished products; and
>
> (b) what the Taxpayer did or had done to its own assets in (1) above, was the source or an important element in establishing the source of its profits’.

40. The first objection is the inclusion of the words ‘and the material before the Board’. The Board repeats paragraph 32 above.

41. The complaint here is whether ‘the Board erred in law in failing to take any or any sufficient account of’. This is a clear attempt to usurp the fact finding function of the Board.

42. The Board made no finding that ‘the Taxpayer was the owner and had possessory rights at all material times of the raw materials, and the finished products in question, before any sale of the finished products’. There is no factual basis for Question 2.

43. The Board does not understand how ‘ownership and possessory rights’ in (a) could become what the Taxpayer ‘did or had done’ in (b). Neither ownership nor possessory rights is an act or are acts.

44. Question 2 is not a proper question for the Court’s opinion.

Question 3

> ‘ Whether on the facts found and the material before the Board, the Board was correct in law to conclude that the Commissioner of Inland Revenue (“CIR”) would be acting contrary to its statutory duties or that an estoppel was sought against it (paragraphs 93, 94),whereas:
>
> (a) the Taxpayer had a legitimate and reasonable expectation that the CIR would continue to apply its practice for many years of apportioning the Taxpayer’s profits on a 50:50 basis, under the CIR’s own Departmental Interpretation and Practice Note No. 21; and
>
> (b) the CIR as a public body, had a duty to act consistently and fairly, absent any material change in circumstances (“Question 3”).’

45. The first objection is the inclusion of the words 'and the material before the Board'. The Board repeats paragraph 32 above.

46. The next objection is that the correct question is not whether 'the Board was correct in law to conclude' but 'whether it was open to the Board' to conclude.

47. Further, the issues were not included in the grounds of appeal and it is not open to the Taxpayer to raise the issues on appeal, many of which are fact sensitive. All that ground (iv) said was that:

> ' The Deputy Commissioner has failed to respect the spirit or letter of the Departmental Interpretation and Practice Note No. 21 and has therefore prejudiced the [Taxpayer] and other taxpayers acting in reliance upon such Departmental Interpretation and Practice Notes'.

48. There was no allegation of any legitimate or reasonable expectation. There was no contention of a duty to act fairly or squarely. There was no allegation of any administrative law reason.

49. The Taxpayer made no attempt to lay the factual foundation for any administrative law reason to apply DIPN 21.

50. Lastly, the Board does not understand the inclusion of estoppel in the question as framed, that is whether Board was correct in law to conclude that CIR 'would be acting contrary to its statutory duties or that an estoppel was sought against it'.

51. Question 3 is not a proper question for the Court's opinion.

Conclusion

52. There is no proper question and no proper question of law. The Board declines to state a case and dismisses the Taxpayer's application for a case stated.

Annexure A
D38/11

BOARD OF REVIEW

Appeal by A Limited

(Date of Hearing: 30 June 2010)

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D E C I S I O N

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Case No. D38/11

Profits tax – source of profits – sections 2, 14(1), 59, 66(1), 66(3), 68(4) and 68(7) of the Inland Revenue Ordinance ('the Ordinance').

Panel: Kenneth Kwok Hing Wai SC (chairman), Shirley Fu Mee Yuk and Vincent P C Kwan.

Date of hearing: 30 June 2010.
Date of decision: 6 December 2011.

The Appellant objected to the Additional Profits Tax Assessments for the years of assessment 1999/2000 to 2002/03 raised on it asserting that only 50% of its profits should be chargeable to profits tax.

The Appellant asserted that it was engaged in the business of manufacturing of metal components and moulds and all the manufacturing operations imperative to the derivation of manufacturing profits were conducted offshore. The work performed by the administrative staff in Hong Kong was only ancillary and supportive in nature. In the premises, the Appellant claimed that the source of profits should be wholly offshore.

The Appellant claimed that as part of the global settlement on the tax filing positions of the group in 1997, it accepted, on a compromise basis, that its manufacturing profits should be assessed on a 50:50 basis as adopted by the Inland Revenue Department for the years of assessment 1991/92 to 1994/95. The Appellant contended that the 50:50 assessment basis should be consistently adopted by the Department throughout the years in view of the fact that the operation of the Appellant had remained unchanged for the years concerned. Furthermore, in accordance with the Departmental Interpretation And Practice Notes No. 21 ('DIPN 21'), the manufacturing profits derived by the Appellant should be apportioned on a 50:50 basis for Hong Kong tax purposes.

However, when requested by the Assessor to provide, inter alia, details of its operation and full sets of documents on the largest transactions for reference, the Accounting Firm representing the Appellant advised that the information and documents requested could not be provided.

Held:

1. Whether the Appellant carried on a 'trade, profession or business' in Hong Kong within the meaning of the Ordinance is a question of fact but the Appellant made no attempt to adduce any or any relevant evidence. The Appellant is not in a position to benefit from sparsity in evidence. Further and in any event, the Appellant is a company incorporated in Hong Kong; acknowledged that it employed supervisory, management and other employees (see paragraph 47(e) and (f) in the decision); purchased the raw materials in Hong Kong (see paragraph 49(d) in the decision); and made deliveries from and accepted deliveries to Hong Kong (see paragraph 44(d) in the decision). The Appellant was registered under the Business Registration Ordinance, Chapter 310, and maintained a business address in Hong Kong. Moreover, the Appellant was at all material times a company incorporated for the purpose of making profits for its shareholders and put its assets to gainful use.

2. Source is a factual question. The burden of proof is on the Appellant. Inability to prove that the assessments appealed against are excessive or incorrect means that the appeal is bound to fail. There is no evidence of any or any offshore manufacturing by the Appellant. There is no identification of the profit-making transactions. The Board was told practically nothing about sale to the Appellant's customers. Much as an appeal tribunal dislikes deciding on the basis of burden of proof, in a case such as this, where there is not an iota of evidence of offshore manufacturing, the Board is driven to the conclusion that the Appellant has failed to discharge the burden of proof.

3. As to the Appellant's claim that the profits it derived from Hong Kong if any was substantially less than the amount assessed, the Appellant has failed to prove that it undertook any offshore manufacturing. It has also failed to identify the profit-making transactions. Last but not least, it has failed to put forward any rational basis for apportionment.

4. The charging section is section 14 and that DIPN 21 has no legal effect in the absence of some administrative law reason (Commissioner of Inland Revenue v Datatronic Ltd [2009] 4 HKLRD 675). The Appellant has made no attempt to lay the factual foundation for any administrative law reason. Further and in any event, the courts will not give effect to a legitimate expectation when to do so will mean that the decision-maker must act contrary to his statutory duties (Interasia Bags Manufacturing Ltd v Commissioner of Inland Revenue [2004] 3 HKLRD 881). The assessor is bound under section 59(1) to assess every person who is in the opinion of the assessor chargeable with tax under the Ordinance. There is also no estoppel arising from assessments in an earlier year (Caffoor v Income Tax Comr [1961] AC 584). In any event, the appellant was not a party to any processing agreement.

Appeal dismissed.

Cases referred to:

China Map Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 486
Kim Eng Securities (Hong Kong) Limited v Commissioner of Inland Revenue (2007) 10 HKCFAR 213
Caffoor v Income Tax Comr [1961] AC 584
Interasia Bags Manufacturing Ltd v Commissioner of Inland Revenue [2004] 3 HKLRD 881
Commissioner of Inland Revenue v Bartica Investment Ltd (1996) 4 HKTC 129
Commissioner of Inland Revenue v Hang Seng Bank Limited [1991] 1 AC 306
Commissioner of Inland Revenue v HK-TVB International Limited [1992] 2 AC 397
Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Limited 3 HKTC 703
Orion Caribbean Limited (in voluntary liquidation) v Commissioner of Inland Revenue [1997] HKLRD 924
Kwong Mile Services Limited v Commissioner of Inland Revenue (2004) 7 HKCFAR 275
ING Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue (2007) 10 HKCFAR 417
Commissioner of Inland Revenue v Datatronic Ltd [2009] 4 HKLRD 675
Commissioner of Inland Revenue v CG Lighting Ltd [2011] 2 HKLRD 763

Philip Wong of Deloitte Touche Tohmatsu for the Taxpayer.
Chan Tak Hong for the Commissioner of Inland Revenue.

Decision:

Introduction

1. The Appellant appealed against the profits tax assessments for the years of assessment 1999/2000 to 2002/03 asserting, among other assertions, that the profits were sourced outside Hong Kong.

2. The Appellant was represented at the hearing by a tax partner ('the Accountant') of an accounting firm ('the Accounting Firm'). The Accountant applied for an adjournment. We were not persuaded by him to do so, and, in the exercise of our discretion, we declined to adjourn. We said our reasons would be given in writing later. This we now do.

3. The Accountant then argued the appeal without calling any witness. He produced a small bundle comprising three documents and two old Board decisions.

The applications for adjournment

4. So far as relevant to the applications for adjournment and based on the materials placed before us, we make the following findings of fact.

5. The Accounting Firm have since the Appellant's incorporation in 1991 until it became dormant in February 2002 been the Appellant's auditors and have at all material times been the Appellant's tax representatives.

6. The assessments appealed against were all dated 15 March 2006. By a letter dated 18 April 2006, the Accounting Firm objected to the assessments.

7. By his determination dated 16 December 2009, the Acting Deputy Commissioner of Inland Revenue confirmed all the assessments objected to.

8. By a letter dated 15 January 2010, a firm of solicitors ('the Solicitors') gave notice of appeal on behalf of the Appellant from the determination.

9. By a letter dated 18 January 2010, the Clerk to the Board of Review ('the Clerk') wrote to the Solicitors asking for information about the appeal, including the estimated length of hearing and particulars of witnesses. The Solicitors were requested to reply within 21 days.

10. By a letter dated 8 February 2010, the Solicitors replied requesting an extension of time to 8 March 2010:

> 'On behalf of our client, we apply for an extension to 8 March 2010 for furnishing a reply to your letter dated 18 January 2010.
>
> The extension is necessary as our client is still considering whether they will have any potential witness to give evidence. We would therefore be grateful if you could grant us the extension as requested.
>
> …'

11. By a letter dated 9 February 2010, the Clerk requested the Solicitors to submit the required information by 8 March 2010 and to expedite matters.

12. No information was forthcoming by 8 March 2010 and the Solicitors wrote to the Clerk again on 9 March 2010 requesting yet another extension:

> '…

Our client would like to apply for a further extension to 22 March 2010.

The extension is necessary as our client is still considering whether they will have any potential witness to give evidence. We would therefore be grateful if you could grant us the further extension as requested.

…'

13. By a letter dated 10 March 2010, the Clerk wrote to the Solicitors impressing on them to submit information by 22 March 2010:

' …

To avoid further delay in the disposal of your client's appeal, please submit the required information to me by **22 March 2010**.'

14. By a letter dated 22 March 2010, a director of the Appellant wrote on behalf of the Appellant to the Clerk furnishing the following information:

' …

We are writing in response to the questions in your 18 January 2010 letter as follows:-

(a) We estimate that 3 to 4 appeal sessions may be required;

(b) We will not engage a legal representative. We instead engage [the Accounting Firm] as our tax representative;

(c) English is the preferred language of proceedings;

(d) We expect to have up to 2 (two) witnesses who will give evidence, who would expect to provide their evidence in English.

In view of our engagement of [the Accounting Firm] as our representative, we are also writing to inform you that our correspondence address has changed as follows –

[The Accounting Firm

The Accounting Firm's address]'

15. By a letter dated 6 May 2010, the Clerk gave the Appellant and the Respondent notice that the appeal was scheduled to be heard on 30 June 2010 (whole day) and requested

the Appellant to furnish their hearing bundles, including witness statements, by 14 June 2010.

16. The Appellant did not lodge any document by 14 June 2010.

17. By a letter dated 15 June 2010, the Clerk forwarded to both parties the first set of documents, B1.

18. As before, nothing was heard or received from the Appellant for yet another week.

19. By a letter dated 22 June 2010, the Clerk forwarded to the parties the hearing bundles (R1 and R2) lodged by the Assessor.

20. Seven days before the scheduled hearing date, that is to say, on 23 June 2010, the Accountant wrote on behalf of the Accounting Firm to the Clerk requesting postponement of the hearing 'until **31 August 2010**' in these terms:

> 'We refer to your letter issued by your Office to the Company on 6 May 2010 in connection with the scheduled hearing to be held on 30 June 2010. On behalf of the Company, we would be grateful if you could grant an extension and postpone the hearing until 31 August 2010. We also request an extension to submit documents until 17 August 2010.
>
> We advise that the Company is in the process of arranging witness(es), being the personnel previously involved in the Company's business operations during the subject years, to attend the hearing. Furthermore, the Company is in the course of preparing the documents and witness statements, and gathering additional evidence to support the appeal. Therefore, we should be grateful if you could consider our extension as requested.
>
> …'

21. The assertion that 'the Company is in the course of preparing the … witness statements' is highly questionable. The Appellant has never embarked on the preparation of any witness statement.

22. By a letter dated 23 June 2010, the Clerk wrote to the Accounting Firm stating that:

> 'Notice of hearing and directions on preparation were given in my letter dated 6 May 2010 to both parties. The panel chairman is not persuaded that your request for time should be acceded to.'

23. The Accountant wrote on behalf of the Accounting Firm by a letter dated 25 June 2010 in these terms:

> ' We refer to the letter issued by your Office to the Company on 23 June 2010 in connection with the hearing scheduled to be held on 30 June 2010. On behalf of the Company, we would sincerely appreciate if you could re-consider our extension request to postpone the hearing until **30 July 2010**.
>
> In addition to the reasons stated in our letter dated 23 June 2010, we advise that the Company, after trying all means, had only very recently been successful getting in touch with the ex-owner of the Company. The ex-owner was intricately involved in the Company's business operations, and has agreed to provide more details of the Company's mode of operations during the years under appeal for the hearing, either by appearing as a witness or providing a written statement.
>
> The ex-owner of the Company was also the Managing Director of the Company before the current shareholder, the [name of the group omitted here] Group, acquired the ownership of the Company. The ex-owner was responsible for overseeing the Company's business operations in Hong Kong and [an overseas place]. In fact since the Company lodged an appeal to the Board of Review, every effort has been made to contact the ex-owner of the Company and its senior employees at the time, as the tax disputes for the relevant years arose during the period of management and ownership of the ex-owner. However, the Company had not maintained contact with the ex-owner after the change of the ownership. Only recently was the Company able to contact the ex-owner through some ex-employees and finally had the chance to speak to the ex-owner. As mentioned above, the ex-owner is willing to assist the Company, either by way of appearing as witness or providing a statement of the Company's operations for the relevant years. Unfortunately, as she is travelling overseas for business from 24 June 2010 and returns only in early July, she is unable to be present in Hong Kong on the 30 June 2010 hearing date.
>
> As the Company's appeal case will involve the need to substantiate the operations in the relevant years, in particular its manufacturing operations in [an overseas place], the presence of the ex-owner or her statement will allow the presentation of important facts for the Board to take into account. The Company is aware that it is required to take proper actions to arrange for its case to be represented on the scheduled date of hearing, but due to the fact that no relationship was maintained between the ex-owner and the Acquiring [name of the group omitted here] Group after the latter had acquired the ownership of the Company, the time expended in locating the ex-owner was really beyond the Company's control.

> Now that the Company has located the ex-owner, the Company respectively requests for your Office and the Board to allow her evidence be taken into account in the hearing. The Company apologizes for any inconvenience caused by this extension request. However, in view of the circumstances explained above, we sincerely request that your Office takes into account these factors and grants an extension of the hearing to 30 July 2010.
>
> As this is the first extension request for postponement of the hearing and the Company now requests for an extension to 30 July 2010 instead of 31 August 2010, we hope your Office will regard this as an exceptional case due to the extenuating circumstances faced by the Company.'

24. By a letter dated 25 June 2010, the Clerk wrote to the Accounting Firm stating that:

> ' …
>
> The panel chairman is still not persuaded that your request for time should be acceded to. Unless the panel is persuaded at the hearing on 30 June 2010 to adjourn by any request which may be made for adjournment, the appellant runs the risk of having its appeal dismissed if it is not ready to proceed.'

25. The Accountant applied at the hearing for an adjournment. He called the group's vice-president of tax for areas which included Hong Kong. She said that she did not take any steps herself to contact the ex-director. What she did was to go back to essentially their general counsel, who was based at a place outside Hong Kong. She testified that the ex-director:

> ' did not say if she would be a witness, so she did not promise anything, but she did indicate that she is willing to help after she returns'.

Reasons for declining to adjourn

26. A taxpayer objecting to an assessment should have gone through its files and documents and should have obtained information from all persons who could provide relevant information in the course of the objection. An appeal to the Board follows an objection to an assessment and an unfavourable determination.

27. The Appellant has been granted two extensions to provide information about the appeal, including particulars of witnesses. It took the Appellant more than two months to write the letter dated 22 March 2010. It conveyed the impression that the question of witnesses had been resolved.

28. So far as searches for relevant documents are concerned, these should have started from April 2006 when the Accounting Firm objected on behalf of the Appellant to the assessments.

29. In this case neither the Appellant nor the Accounting Firm seemed to have prosecuted the appeal with any diligence.

30. The Accounting Firm were content to allow their firm to go on record as the Appellant's tax representatives. However, they did not start work until about a week before the hearing. They ran the risk of bringing themselves into disrepute arising from poor preparation.

31. We have already said that the assertion that 'the Company is in the course of preparing the … witness statements' is highly questionable. Little or no progress seemed to have been made since the Clerk's letter dated 18 January 2010.

32. More importantly and in any event, the ex-director 'did not promise anything'. The Appellant has simply not made out any case for an adjournment applied for so late in the day.

33. In the exercise of our discretion, we declined to adjourn.

Facts recited in the determination and agreed by the Appellant

34. This is an appeal against the determination of the Acting Deputy Commissioner of Inland Revenue dated 16 December 2009 whereby:

(a) Additional Profits Tax Assessment for the year of assessment 1999/2000 dated 15 March 2006, showing additional assessable profits of $9,115,188 with additional tax payable thereon of $1,458,430 was confirmed.

(b) Additional Profits Tax Assessment for the year of assessment 2000/01 dated 15 March 2006, showing additional assessable profits of $7,938,390 with additional tax payable thereon of $1,270,142 was confirmed.

(c) Additional Profits Tax Assessment for the year of assessment 2001/02 dated 15 March 2006, showing additional assessable profits of 1,483,698 with additional tax payable thereon of $237,392 was confirmed.

(d) Additional Profits Tax Assessment for the year of assessment 2002/03 dated 15 March 2006, showing additional assessable profits of $18,272,583 with additional tax payable thereon of $2,923,613 was confirmed.

35. Actual source of income is a 'practical hard matter of fact'. What a taxpayer should do is to identify 'what the taxpayer has done to earn the profit in question and where he has done it'. Regrettably, instead of presenting a coherent set of relevant facts, some taxpayers and their advisers put forward irrelevant facts and lengthy arguments and insisted on their inclusion in the determination. This unnecessarily burdens the Board's decisions, as is the case in this appeal.

36. The following facts in the section 'Facts upon which the determination as arrived at' were agreed by the Appellant and we find them as facts.

37. The Appellant has objected to the Additional Profits Tax Assessments for the years of assessment 1999/2000 to 2002/03 raised on it asserting that only 50% of its profits should be chargeable to profits tax.

38. (a) The Appellant is a private company incorporated in Hong Kong in 1991. At all relevant times, it described its main business activity as 'manufacturing of metal components and moulds'. The Appellant became dormant in February 2002.

(b) Up to the year 2001, the Appellant closed its accounts on 31 December annually. Then the Appellant changed its accounting year end date to 31 March.

39. (a) On divers dates, the Appellant filed Profits Tax Returns for the years of assessment 1999/2000 to 2002/03. The Appellant claimed that only 50% of its profits derived from the manufacturing operation [overseas] should be chargeable to profits tax and declared the following assessable profits or adjusted loss:

	1998/99	1999/2000	2000/01	2001/02	2002/03
Basis period	1-1-1998 – 31-12-1998	1-1-1999 – 31-12-1999	1-1-2000 – 31-12-2000	1-1-2001 – 31-12-2001	1-1-2002 – 31-3-2003
	$	$	$	$	$
Profits/(Loss) per tax computation	(1,736,689)	20,160,065	15,876,781	2,967,395	36,545,166
Less: 50% of the profits/(loss) *	(964,844)	10,080,032	7,938,390	1,483,698	18,272,583
Assessable profits/(Adjusted loss) per return	(771,845)	10,080,033	7,938,391	1,483,697	18,272,583

* Being 50% of the profits or loss derived from the manufacturing operation [overseas].

(b) The Assessor issued to the Appellant Statement of Loss for the year of assessment 1998/99 and Profits Tax Assessments for the years of assessment 1999/2000 to 2002/03 on the loss or profits, as the case may be, returned. The Appellant did not dispute the Statement of Loss or object against the Profits Tax Assessments.

40. The Assessor requested the Appellant to provide a copy of the processing agreement made with the relevant [overseas] party in support of its offshore claim. The Accounting Firm, on behalf of the Appellant, replied that the Appellant had not entered into any processing agreement with any [overseas] party. It was Immediate Holding Company [current and previous names omitted here] the Appellant's immediate holding company, that had entered into a processing agreement with [an overseas] party. Immediate Holding Company subcontracted part of the manufacturing process to its subsidiaries, including the Appellant. The Appellant acted as a subcontractor of Immediate Holding Company, manufacturing metal components and moulds [offshore]. Since all the Appellant's profits were derived from its manufacturing activities carried out [offshore], the Appellant had claimed all its manufacturing profits as offshore sourced and therefore, not subject to Hong Kong profits tax. However, on settlement of the objections lodged for the years of assessment 1991/92 to 1994/95, it was the contention of the Inland Revenue Department ('the Department') to adopt the 50:50 assessment basis on the Appellant as well as its other group companies. The 50:50 assessment basis should be consistently adopted throughout the years in view of the fact that the operation of the Appellant had remained unchanged for the years concerned.

41. The Assessor considered that the whole of the Appellant's profits were chargeable to profits tax and issued to the Appellant the following Revised Statement of Loss for the year of assessment 1998/99 and Additional Profits Tax Assessments for the years of assessment 1999/2000 to 2002/03:

(a) Year of assessment 1998/99

	$
Loss for the year and carried forward [Paragraph 39(a)]	1,736,689

(b) Year of assessment 1999/2000

Assessable profits [Paragraph 39(a)]	20,160,065
Less: Loss b/f set-off	(1,736,689)
	18,423,376
Less: Profits previously assessed *	(9,308,188)
Additional assessable profits	9,115,188
Additional tax payable thereon	1,458,430

* $10,080,033 less loss b/f $771,845 [Paragraphs 39(a) and (b)]

Statement of Loss

	$
Loss b/f	1,736,689
Less: Loss set-off	(1,736,689)
Loss c/f	0

(c) Years of assessment 2000/01, 2001/02 and 2002/03

	2000/01	2001/02	2002/03
	$	$	$
Additional assessable profits [Paragraph 39(a)]	7,938,390	1,483,698	18,272,583
Additional tax payable thereon	1,270,142	237,392	2,923,613

42. The Accounting Firm, on behalf of the Appellant, objected against the Additional Profits Tax Assessments for the years of assessment 1999/2000 to 2002/03 in the following terms:

(a) '[The Appellant] was engaged in the business of manufacturing of metal components and mould for the captioned years of assessment. All the manufacturing operations and activities were conducted [offshore] and hence all manufacturing profits derived therefrom are offshore sourced and not subject to Hong Kong profits tax.'

(b) 'Pursuant to our letter dated 27 June 1996, it was submitted that [the Appellant], on a without prejudice basis, adopted 50:50 apportionment basis for the years of assessment 1991/92 to 1994/95 to help solving the disputes with your Department and to avoid unnecessary technical arguments on the tax positions of [the Appellant] (though we maintained the view that the profits derived by [the Appellant] are offshore sourced and wholly non-taxable). Following this departmental practice and on the basis that there had been no change in the substance and mode of operations of [the Appellant] during the relevant years, this 50:50 apportionment basis had been consistently applied throughout the captioned years of assessment.'

(c) 'The Assessments are excessive as only 50% of the profits derived by [the Appellant] are subject to Hong Kong profits tax, or otherwise incorrect. For instance, the tax loss brought forward from the year of assessment 1998/99 should be HK$771,845 … instead of HK$1,736,689 …'

43. By a letter dated 2 May 2006, the Assessor requested the Appellant to provide, inter alia, details of its operation and full sets of documents on the largest transactions for

reference. In reply, the Accounting Firm advised that the information and documents requested could not be provided for the following reasons:

(a) The Appellant was acquired by the Acquiring Company [name of company omitted here], a company incorporated [outside Hong Kong], in the year of assessment 2002/03. Before that the Appellant was part of the Acquired [name omitted here] Group.

(b) Due to the poor management for the previous shareholder, there was no systematic keeping of business documents and accounting records. As the Appellant had already become dormant at the time of acquisition, the Acquiring Group did not perform any detailed due diligence review on the Appellant's tax positions, nor did it examine or attempt to retrieve the accounting records of the Appellant prior to the acquisition.

(c) After the acquisition, the Appellant remained dormant. With the lapse of time and the gradual departure of the relevant staff, there was no longer any person in the Appellant that could help to locate or retrieve the past business records.

44. The Accounting Firm asserted that the Appellant's operations during the relevant period were as follows:

(a) The Appellant was previously a member of the Acquired Group, which was engaged in the manufacture and sale of plastic, metal and mould products. Immediate Holding Company had entered into commission processing arrangements with certain [overseas] partners to conduct its manufacturing operations in processing factories [overseas]. These [overseas] partners were:

(i) [name omitted here]

(ii) Factory 2

(iii) Factory 1

Copies of the tax registration certificates of the three [overseas] parties were provided by the Accounting Firm.

(b) Being part of the Acquired Group, the Appellant was engaged in the manufacture of metal components and moulds and undertook its manufacturing operations in the [overseas] factories. The Appellant conducted its manufacturing process [overseas] by sharing the facilities in the [overseas] factories without the need to get business licence or tax registration of its own.

(c) Immediate Holding Company sub-leased part of the factory premises and staff quarters [overseas] to the Appellant to allow the Appellant to conduct its own manufacturing process in the [overseas] factories.

(d) The Appellant was responsible for the provision of machinery for the manufacturing of metal components and moulds deployed in the [overseas] factories. The Appellant was also responsible for the provision of raw materials for the manufacturing work. The raw materials were delivered to the [overseas] factories on consignment basis. In the course of the production process, the Appellant retained the legal title of the raw materials, work-in-progress and finished goods. The finished goods were delivered to the Appellant in Hong Kong.

(e) Although the Appellant did not have a formal and separate processing arrangement of its own, it paid subcontracting charges to the [overseas] partners through Immediate Holding Company in accordance with the share of subcontracting costs incurred by and payable to the [overseas] partners pursuant to the commission processing arrangements entered into between Immediate Holding Company and the [overseas] partners.

(f) The Appellant recruited staff at the supervisory and management level, who provided know-how and supervision to the locally recruited labour and managed the day to day operations of the [overseas] factories.

(g) Apart from the staff recruited, assigned and stationed in the [overseas] factories, the Appellant had administrative staff stationed in Hong Kong. They were responsible for the administrative and supportive functions. The Appellant had also engaged [name omitted here], a related company, for the provision of administrative and accounting services in Hong Kong.

45. The Accounting Firm made the following submission:

(a) The Appellant was engaged in the business of manufacturing of metal components and moulds. Through the processing arrangements between Immediate Holding Company and the [overseas] partners, the Appellant was able to conduct the entire manufacturing operations in the [overseas] factories. Being a manufacturer, the Appellant's source of profits should be determined by the location where the manufacturing operations took place.

(b) All the manufacturing operations (production, assembly, quality control, delivery of finished goods, etc.) imperative to the derivation of manufacturing profits, were conducted by the staff recruited, assigned

and stationed in the [an overseas place] factories together with the local labour recruited by the [an overseas place] partners (pursuant to the commission processing arrangements entered into with Immediate Holding Company). The work performed by the administrative staff in Hong Kong was only ancillary and supportive in nature. In view of the above, the Appellant's source of profits should be wholly offshore.

(c) However as part of the global settlement on the tax filing positions of the Acquired Group in 1997, the Appellant accepted, on a compromise basis, that the Appellant's manufacturing profits should be assessed on a 50:50 basis. Furthermore, in accordance with the Departmental Interpretation And Practice Notes No. 21 ('DIPN 21'), the manufacturing profits derived by the Appellant should be apportioned on a 50:50 basis for Hong Kong tax purposes.

46. The Assessor set out the facts of the case as above for the Appellant's comment. The Accounting Firm, in reply, confirmed that the Appellant agreed to the facts as set out in principle and contended that the Appellant's tax filing position for the years of assessment 1991/92 to 1994/95 was relevant in considering the offshore profits claim for the years of assessment 1999/2000 to 2002/03. The Accounting Firm reiterated that, for the years of assessment 1991/92 to 1994/95, the Appellant had filed its Profits Tax Returns on a wholly offshore basis as the Appellant was a manufacturer and all the manufacturing activities that gave rise to the profits were carried out [offshore]. The Department then issued an enquiry letter to the Appellant on its operations. By a letter of 22 December 1995, the Appellant submitted a detailed description of its operations with supporting documents. Subsequently the Department invited the Appellant to submit revised tax computations for the years of assessment 1991/92 to 1994/95 on a 50:50 apportionment basis. Ultimately, the objections for those years were settled on this basis. As such, the Appellant would have all the reasonable grounds to believe that this tax filing basis would be adopted in future years unless there was a substantial change in its operational model that precluded it from adopting the 50:50 apportionment basis. Hence, the Appellant had filed its Profits Tax Returns on a 50:50 apportionment basis from the year of assessment 1995/96 onwards up to and including the year of assessment 2002/03 when the Appellant ceased its business in Hong Kong.

47. The Accounting Firm further elaborated on the operations of the Appellant as follows:

<u>Factory 1</u>

(a) Factory 1 was operated [overseas] pursuant to a contract processing agreement entered into between Immediate Holding Company and [an overseas] party, [name omitted here].

(b) The Appellant was principally engaged in the manufacture of metal components and moulds in all the relevant years. In order to achieve economies of scale in the overall manufacturing operations within the Acquired Group, the Appellant had shared the facilities of Factory 1 with Immediate Holding Company since its incorporation in 1991. Nevertheless, the finished goods of Immediate Holding Company and those of the Appellant were so distinct that certain areas within Factory 1, namely [name omitted here] (the metal mould division of Factory 1), were separated from the rest of the factory facilities. The Appellant directly managed the metal components and mould manufacturing operations carried out in the metal mould division of the factory. The Appellant was also responsible for the provision of plant and machinery, raw materials, technical skills, training and supervision of the local production workers.

Factory 2

(c) With the increasing demand for goods, capacity of the metal mould division within Factory 1 was fully utilized and the Appellant had to look for other factory premises to conduct the manufacturing operations in order to meet market need.

(d) In December 1995, Immediate Holding Company entered into another contract processing agreement with [name omitted here] to operate Factory 2. With such new agreement in place, the Appellant also shared part of the facilities of Factory 2 to carry out the manufacturing work. As in the case of Factory 1, certain part of the factory premises, namely [name omitted here] (the metal mould division of Factory 2), were separated out for use by the Appellant. The Appellant was again responsible for the provision of plant and machinery, raw materials, technical skills, training and supervision of the local production workers.

Involvement of the Appellant's personnel in the [an overseas place] operations

(e) The Appellant employed supervisory and management staff in Hong Kong to provide technical support and training to the local workers; supervise the manufacturing operations at the [an overseas place] factories; provide quality control support at the [an overseas place] factories; and procure raw materials used in the manufacturing operations. During the years of assessment 1999/2000 to 2002/03, staff members holding the following job titles were employed by the Appellant:

(i) Purchasing Executive

(ii) Purchasing Manager

(iii) Project Engineer

(iv) Tooling Manager (Metal Department)

(v) Quality Control Manager

(vi) Assistant Sales Manager

(vii) Accounts Clerk

(f) The project engineer, tooling manager and the quality control manager were required to visit the [overseas] factories on a regular basis. The other employees were stationed in the Hong Kong office and were responsible for administrative and supporting functions such as sourcing of materials, processing of customers' orders and keeping books of accounts.

48. The Accounting Firm provided, inter alia, copies of the following documents in support of their claims:

(a) contract processing agreement between Immediate Holding Company, [name omitted here] and the Factory 1 dated 7 April 1989;

(b) business licence of Factory 1 dated 8 August 1989;

(c) sample documents on certain transactions in late 1993;

[Note: The same copies of documents stated in Paragraphs 48(a) to (c) above were attached to the Accounting Firm' reply dated 22 December 1995 to the Assessor's enquiries [Paragraph 46].]

(d) demand for payment dated 11 July 1999 issued by [name omitted here] to Immediate Holding Company;

(e) breakdown of 工人管理費 and 工繳費 for June 1999;

(f) voucher and receipt of temporary staff costs（臨時工調配費）issued in August 1999;

(g) transportation receipt/invoice dated 19 November 1999 issued by the Forwarder;

(h) import goods examination record sheet … dated 19 November 1999 issued by the relevant [an overseas place] customs authority; and

(i) two invoices, both of 19 November 1999, for carparking fee and cargo loading charge respectively.

49. With regard to the documents at paragraph 48, the Accounting Firm explained as follows:

(a) As the Appellant had shared the factory facilities of the Factory 2, it had shared the rental charges and staff management fee payable to [name omitted here] under the contract processing agreement. The rental charges were included as manufacturing expenses in the Appellant's financial statements. The demand for payment showed the staff management fee and processing fee（工人管理費 and 工繳費）payable by Immediate Holding Company for June 1999 according to the contract processing agreement. The Appellant shared a portion of the fees based on the actual headcount utilized by the Appellant in the metal mould division of the Factory 2.

(b) The Appellant shared the temporary staff costs for July 1999 on a headcount basis. The bottom of Appendix E gave the hand script calculation.

(c) All these substantiated that the Appellant did share the factory facilities and operated the metal mould division of Factory 2 for its metal components and moulds manufacturing business.

(d) The Appellant was responsible for the procurement of raw materials for use in the manufacturing operations. The Appellant purchased the raw materials in Hong Kong and appointed the Forwarder, an unrelated forwarder, to deliver the raw materials to the factory under the name of Immediate Holding Company as Immediate Holding Company was a party to the contract processing agreement. The documents at Appendices F1 to F3 illustrated the delivery of raw materials from Hong Kong to Factory 2. The chop on Appendix F1, which read as '… 收貨章', showed that raw materials were sent to the metal mould division of Factory 2. The materials consigned to the factory were all metal plates, which could only be used by the Appellant for the manufacture of metal related products.

Grounds of appeal

50. The grounds of appeal contained in the Solicitors' notice of appeal dated 15 January 2010 read as follows:

'(i) The [Appellant] did not carry on a "trade, profession or business" in Hong Kong within the meaning of the IRO during the years in dispute.

(ii) Assuming, which is not the case, that the [Appellant] did carry on business in Hong Kong, such profits as were earned by the [Appellant] did not "arise in" or "derive from" Hong Kong within the meaning of the IRO during the years in dispute.

(iii) Assuming, which is not the case, that the [Appellant] did carry on business in Hong Kong and did derive some profits from Hong Kong within the meaning of the IRO during the years in dispute, the amount of such profit is substantially less than the amount assessed by the Deputy Commissioner.

(iv) The Deputy Commissioner has failed to respect the spirit or letter of the Departmental Interpretation and Practice Note No. 21 and has therefore prejudiced the [Appellant] and other taxpayers acting in reliance upon such Departmental Interpretation and Practice Notes.

(v) The revised statement of loss and the additional assessments are incorrect, and there is no other basis in the IRO that supports the revised statement of loss and the assessments.'

The relevant provisions in the Inland Revenue Ordinance, Chapter 112

51. Section 2 provides, among others, that:

'*"profits arising in or derived from Hong Kong"(於香港產生或得自香港的利潤) for the purposes of Part IV shall, without in any way limiting the meaning of the term, include all profits from business transacted in Hong Kong, whether directly or through an agent'*.

52. Section 14(1) provides that:

'*Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.'*

53. An assessor has the statutory duty under section 59 to assess:

'*Every person who is in the opinion of an assessor chargeable with tax under this Ordinance shall be assessed by him as soon as may be after the expiration*

of the time limited by the notice requiring him to furnish a return under section 51(1):

Provided that the assessor may assess any person at any time if he is of opinion that such person is about to leave Hong Kong, or that for any other reason it is expedient to do so.'

54. Sections 66(1) and (3) provide that:

'*(1) Any person (hereinafter referred to as the appellant) who has validly objected to an assessment but with whom the Commissioner in considering the objection has failed to agree may ... either himself or by his authorized representative give notice of appeal to the Board; but no such notice shall be entertained unless it is given in writing to the clerk to the Board and is accompanied by a copy of the Commissioner's written determination together with a copy of the reasons therefor and of the statement of facts and a statement of the grounds of appeal.'*

'*(3) Save with the consent of the Board and on such terms as the Board may determine, an appellant may not at the hearing of his appeal rely on any grounds of appeal other than the grounds contained in his statement of grounds of appeal given in accordance with subsection (1).'*

55. Section 68(4) provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the appellant.

56. Section 68(7) provides that:

'*At the hearing of the appeal the Board may, subject to the provisions of section 66(3), admit or reject any evidence adduced, whether oral or documentary, and the provisions of the Evidence Ordinance (Cap 8), relating to the admissibility of evidence shall not apply.'*

Relevant authorities

57. The taxpayer is bound by the grounds of appeal. They restrict the scope of evidence to be adduced before the Board[5]. Unless permitted by the Board under section 66(3), the appeal is confined to the original grounds of appeal[6]:

'*9. By its representative, each of the Taxpayers put forward the grounds of appeal that the profits in question "were capital in nature and were not assessable to Profits Tax or alternatively that the assessment was*

[5] Section 68(7).

[6] China Map Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 486 at paragraphs 9 and 10.

excessive". None of the Taxpayers pursued its alternative ground that the assessments were excessive. That left only one question raised by the grounds of appeal given in accordance with s.66(1). Did the profits in question arise from the sale of capital assets? But at the hearing before us, Mr Patrick Fung SC for the Taxpayers contended that there was an antecedent question. Were the profits in question from the carrying on of a trade, profession or business?

10. No such question is raised by the Taxpayers' grounds of appeal given in accordance with s.66(1). But Mr Fung contended that the Board is to be treated as having consented under s.66(3) to the Taxpayers relying on a fresh ground which raised such a question. For this contention, Mr Fung relied on an exchange between the Board's chairman and the Taxpayers' counsel (not Mr Fung or his junior Ms Catrina Lam). That exchange took place after the close of the evidence and during final speech. By its nature, such a question is fact-sensitive and its answer inherently dependent on evidence. For a tribunal of fact to entertain such a question after the close of the evidence would be unusual and plainly inappropriate if done without offering the party against whom the question is raised an opportunity to call further evidence. No such opportunity was offered to the Revenue. We do not think that the Board is to be treated as having consented under s.66(3) to the Taxpayers relying on a fresh ground which raised the antecedent question for which Mr Fung now contends. If and whenever s.66(3) consent is sought, it should be sought fairly, squarely and unambiguously. Nothing of that kind occurred in this case.'

58. As the taxpayer bears the burden of proof, it is not in a position to benefit from sparsity in evidence[7]:

'50. The bulk of the evidence relates to dealings on the Singapore Stock Exchange. In relation to dealings on the other foreign stock exchanges, the evidence is sparse. The Taxpayer is not in the position to benefit from such sparsity. After all, it bears the burden of showing that the assessments are wrong. In that endeavour, it has chosen to present its arguments as if the Singaporean position represents the entirety of this case. The Revenue accepts that approach, so the Taxpayer can rely on Singapore as representative. But there is no basis on which it can succeed in relation to any other foreign stock exchange if it cannot succeed in relation to the one in Singapore.'

[7] Kim Eng Securities (Hong Kong) Limited v Commissioner of Inland Revenue (2007) 10 HKCFAR 213 at paragraph 50

59. In Caffoor v Income Tax Comr [1961] AC 584, the Privy Council held that the respondent was not estopped by the decision of the Board of Review for the year 1949-50 from challenging the appellants' claim to exemption for the subsequent years. A question of liability to tax for one year was always to be treated as inherently a different issue from that of liability for another year - as not eadem quaestio - even though there might appear to be similarity or identity in the questions of law on which they respectively depended, and the principle of res judicata did not apply. It was not the status of the tribunal itself, judicial or administrative, that formed the determining element for estoppel in cases of this kind but the limited nature of the question that was within the tribunal's jurisdiction.

60. In Interasia Bags Manufacturing Ltd v Commissioner of Inland Revenue [2004] 3 HKLRD 881, Hartmann J (as he then was) held that the courts will not give effect to a legitimate expectation when to do so will mean that the decision-maker must act contrary to his statutory duties:

> '***The second challenge: legitimate expectation***
>
> *102. I have spoken of this challenge in para.16 of this judgment, citing from the applicant's form 86A. To repeat it, that citation reads :*
>
> > *"The 1992-94 assessments constituted representations on the [Commissioner's] part that profits attributable to the overseas sales [of the applicant] arise or are derived outside Hong Kong.*
> >
> > *The applicant was and is entitled to a legitimate expectation that, unless there is a change in the [Commissioner's] policy or a change in law, similar profits in subsequent years would likewise be considered by the [Commissioner] as arising or derived outside Hong Kong."*
>
> *103. The legitimate expectation that is asserted is not procedural, it is substantive. It is the applicant's case that, absent a change in law or policy, having had earlier profits assessed as earned offshore, it will also have similar future profits assessed as being earned offshore and therefore free of tax.*
>
> *104. It is for the applicant, of course, to establish the existence of a legitimate expectation. In this regard, in Ng Siu Tung & Others v. Director of Immigration [2002] 1 HKLRD 561, the Court of Final Appeal said that, as a general rule, any promise or undertaking, if it is to support a legitimate expectation, must be clear and unambiguous. This was subject only to the following limited qualification stated (para.104, page 605) :*
>
> > *"While we accept that, generally speaking, a representation relied upon to support a legitimate expectation must be clear and*

> *unambiguous, we recognise that there will be cases where a representation is reasonably susceptible of competing constructions. In such a case, far from adopting the construction which is most favourable to the person asserting the legitimate expectation, the correct approach is to accept the interpretation applied by the public authority, subject to the application of the Wednesbury unreasonableness test.*
>
> …
>
> *Generally speaking, no unfairness can arise when the government acts on a rational view of its policy statements. Policy statements are often expressed in broad terms, leaving the details to be worked out. To say that, because they are broadly and imprecisely expressed, such statements can never generate a legitimate expectation would be too restrictive an approach. But in cases where the details of a broad policy are subsequently identified or ascertained and they reflect a rational development of the broad policy earlier announced, the court should have regard to them."*

105. While a promise or undertaking may give rise to an expectation, for that expectation to be legitimate, it must be a reasonable one. In this regard, in Ng Siu Tung, the Court of Final Appeal said (para.101, page 602):

> *"Though the concept of 'legitimate expectation' is somewhat lacking in precision, it is now firmly established that to be legitimate, the expectation must be reasonable (A-G of Hong Kong v Ng Yuen Shiu [1983] 2 AC 629 at p.636, per Lord Fraser of Tullybelton), that is, reasonable in the light of the official conduct which is said to have given rise to the expectation. Whether an expectation is legitimate in this sense depends, at least in part, upon the conduct of the relevant public authority and what it has committed itself to. Whether an expectation is legitimate, and to what extent, must also depend upon what the applicants are entitled to expect. The requirement of legitimacy means that judicial decisions 'must be founded not only on what the claimant factually expected, but also on what the claimant, bearing in mind any relevant considerations of policy and principle, was entitled to expect".*

106. Importantly, the courts will not give effect to a legitimate expectation when to do so will mean that the decision-maker must act contrary to his statutory duties. In this regard, in Ng Siu Tung the Court of Final Appeal said (para.112, page 606):

> *"The principle that the court will not give effect to a legitimate expectation where to do so would involve the decision-maker acting contrary to law is fundamental (A-G of Hong Kong v Ng Yuen Shiu [1983] 2 AC 629 at p.638; R v North and East Devon Health Authority, ex p Coughlan [2000] 2 WLR 622 at pp.647, 651, 656; R v Secretary of State for Education and Employment, ex p B (A Minor) [2000] 1 WLR 1115 at pp.1125, 1132). Consistently with this principle, the decision-maker cannot give effect to an expectation by exercising his statutory discretion 'in a way which undermines the statutory purpose' (R v Secretary of State for Education and Employment, ex p B (A Minor) at p.1132, per Sedley LJ)."*

107. On the basis of these principles, what representations of the Commissioner are said to have given rise to the legitimate expectation that is asserted? As I understand it, the representations are said to have been contained in the notices of assessment originally issued by the Commissioner for the 1992/1993 and 1993/1994 tax years. But both those notices were in a standard form. I have cited that form in para.24. The form is to the following effect:

> *"According to the Return and information submitted, there are no profits chargeable to Profits Tax for the above mentioned year of assessment."*

As I have said in para.25, the notices were not accompanied by any explanatory letter nor were there any communications in respect of the notices between the Commissioner and the applicant in terms of which the Commissioner gave any promises, assurances or undertakings.

108. If Mr Kwok has been correct in his submissions, it must follow that all potential tax payers who have received a standard form notice of the kind I have just cited will benefit from the same legitimate expectation asserted by the applicant. Is that reasonable? Patently, in my view, it is not.

109. In my judgment, there can be no basis for saying that the notices have constituted any form of representation binding the Commissioner to future conduct. First, the notices clearly state that they concern only the stated year of assessment, not any future year or years. Second, the notices clearly state that the Commissioner's decision contained in each notice is based only on the information supplied by the applicant in its return. The notices pretend to no form of representation as to the future nor, in my view, can they be read as such.

110. In my judgment, Mr Cooney has expressed the matter succinctly in saying the following : "Bearing in mind that the Commissioner has a duty to collect taxes and the power to issue additional assessments under s.60, the applicant was only entitled to expect that the assessments were for their own particular year and were subject to the power of the Commissioner to review and issue additional assessments."

111. In its letter of 10 June 2003, cited in para.64 of this judgment, the applicant's accountants, spoke of an "agreement" reached with the Commissioner. But there was no agreement, that is clear, certainly no form of agreement that would prevent the Commissioner pursuing a review in terms of s.60(1) of the Ordinance.

112. In my judgment, there is no merit whatsoever in the claim that the applicant was entitled to rely on the form of legitimate expectation it has asserted.'

61. In Commissioner of Inland Revenue v Bartica Investment Ltd (1996) 4 HKTC 129, Cheung J (as he then was) set out the principles on the question of whether the taxpayer was carrying on a business which was a question of fact:

'*The authority in this area is **American Leaf Blending Co Sd Bhd v Director General of Inland Revenue** [1978] STC 561. The company had its principal object of carrying on a tobacco business. Its Memorandum of Association covered a wide variety of objects including the granting of licences over, and generally dealing with, the land and other rights over property of the company. After it had ceased trading in tobacco the company began granting licences to others to use and occupy the factory and warehouse for storage purposes in return for a monthly rent. The issue was whether the rental income was from a "source consisting of a business". The decision of the Privy Council was delivered by Lord Diplock. The following principles can be extracted from the speech:*

(1) Rents may constitute income from a source consisting of a business if they are receivable in the course of carrying on a business of putting the taxpayer's property to profitable use by letting it out for rent.

(2) The question whether the company was carrying on a business of letting out its premises for rent is one of fact.

(3) The Privy Council would not endorse the view that every isolated act of a kind that is authorised by its memorandum if done by company necessarily constitutes the carrying on of a business.

(4) Business is a wider concept than trade.

(5) In the case of a private individual it may well be that the mere receipt of rents from property that he owns raises no presumption that he is carrying on a business.

(6) In contrast, in the case of a company incorporated for the purpose of making profits for its shareholders, any gainful use to which it puts any of its assets prima facie amounts to the carrying on of a business.

(7) Where the gainful use to which a company's property is put is letting it out for rent, it is not easy to envisage circumstances that are likely to arise in practice which would displace the prima facie inference that in so doing so it was carrying on a business.

(8) The carrying on of business, usually calls for some activity on the part of whoever carries it on, though, depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between.' (at pp. 158-159)

'*While ultimately it is a question of fact whether the taxpayer was carrying on business, the prima facie inference for a company incorporated for the purpose of making profits for its shareholders and puts its assets to gainful use is that it is carrying on a business.'* (at p. 162)

'*Question of fact*

Whether a business is carried out in a place is a question of fact. This is a matter referred to by Lord Parmoor.

In the earlier case of Werle & Co. v. Colquhoun, Tax Cases 402. Esher M. held at page 408 that:

> *"... in each case, when you come to consider is there a trade carried on in England, it is a question of fact."'* (at p. 166)

'*The taxpayer kept all of its accounting and other records in Hong Kong. They were maintained by Price Waterhouse. Board meetings of the nominee directors took place in Hong Kong by way of paper meetings. Certainly, as far as Westpac Bank was concerned, although instructions were given to and accepted by the bank from the family members, the legal authorised signatories of the taxpayer were the nominees of Price Waterhouse who were required to confirm the instructions. This is a case where the true and the only reasonable conclusion contradicts the determination of the Board. All the facts point towards the business being carried on in Hong Kong.'* (at p. 167)

62. On the question of source, one often starts with Lord Bridge's advice in Commissioner of Inland Revenue v Hang Seng Bank Limited [1991] 1 AC 306:

(a) Three conditions must be satisfied before a charge to tax can arise under section 14: (1) the taxpayer must carry on a trade, profession or business in Hong Kong; (2) the profits to be charged must be 'from such trade, profession or business,' which their Lordships construe to mean from the trade, profession or business carried on by the taxpayer in Hong Kong; (3) the profits must be 'profits arising in or derived from' Hong Kong. Thus the structure of section 14 presupposes that the profits of a business carried on in Hong Kong may accrue from different sources, some located within Hong Kong, others overseas. The former are taxable, the latter are not (page 318).

(b) A distinction must fall to be made between profits arising in or derived from Hong Kong ('Hong Kong profits') and profits arising in or derived from a place outside Hong Kong ('offshore profits') according to the nature of the different transactions by which the profits are generated (page 319).

(c) 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 (page 322).

(d) It is impossible to lay down precise rules of law by which the answer to that question is to be determined (page 322).

(e) 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 (pages 322- 323).

(f) There may, of course, be cases where the gross profits deriving from an individual transaction will have arisen in or derived from different places. Thus, for example, goods sold outside Hong Kong may have been subject to manufacturing and finishing processes which took place partly in Hong Kong and partly overseas. In such a case the absence of a specific provision for apportionment in the Ordinance would not obviate the necessity to apportion the gross profit on sale as having arisen partly in Hong Kong and partly outside Hong Kong (page 323).

63. The guiding principle laid down by Lord Bridge in the Hang Seng Bank case was expanded and applied by Lord Jauncey in Commissioner of Inland Revenue v HK-TVB International Limited [1992] 2 AC 397 at page 407 as follows:

> '*One looks to see what the taxpayer has done to earn the profit in question and where he has done it.'*
>
> Lord Jauncey went on to state that:
>
> (a) When Lord Bridge, after quoting the guiding principle, gave certain examples he was not intending thereby to lay down an exhaustive list of tests to be applied in all cases in determining whether or not profits arose in or derived from Hong Kong. (page 407)
>
> (b) It is a mistake to try to find an analogy between the facts in this appeal and the example given by Lord Bridge in the Hang Seng Bank case. The proper approach is to ascertain what were the operations which produced the relevant profits and where those operations took place. (page 409)

64. Fuad VP, delivering the leading judgment of the majority in Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Limited 3 HKTC 703, cited Lord Bridge's 'broad guiding principle' expressed in the *Hang Seng Bank* case, as expanded by Lord Jauncey in the HK-TVBI case and continued to point out that it was the operation of the taxpayer which were the relevant consideration (page 729):

> '*"one looks to see what the taxpayer has done to earn the profit in question and where he has done it."*
>
> *When addressing the question the Board had formulated for itself "where did the operations take place from which the profits in substance arise", in my respectful judgment the Board did not appear to appreciate that it is the operations of the taxpayer which are the relevant consideration. If the Board had been able to benefit from the decisions of the Privy Council in the Hang Seng Bank and the HK-TVB case, I have little doubt the Board's general approach to the issues would not have been the same. I think that Miss Li was right when she submitted that the case stated clearly indicated that the Board had looked more at what the overseas brokers had done to earn their profits. Of course, there would have been no 'additional remuneration' ultimately credited to the Taxpayer if the brokers had not executed the relevant transactions, and these took place abroad, but this does not tell us what the Taxpayer did (and where) to earn its profit. The Taxpayer, it seems to me, while carrying on business in Hong Kong, instructed the overseas broker from Hong Kong to execute a particular transaction. The Taxpayer was carrying out its contractual duties to its client and performing services under the management agreement in Hong Kong and in return receiving the management fee as well as the 'additional remuneration as manager' to which it was entitled under that agreement. In my view, the Taxpayer did nothing abroad to earn the profit sought to be taxed. The Taxpayer would be acting in precisely the same manner, and in the same place, to earn its profit, whether it was giving instructions, in*

pursuance of a management contract, to a broker in Hong Kong or to one overseas. The profit to the Taxpayer was generated in Hong Kong from that contract although it could be traced back to the transaction which earned the broker a commission.'

65. The ascertaining of the actual source of income is a 'practical hard matter of fact' and no simple, single, legal test can be employed, Orion Caribbean Limited (in voluntary liquidation) v Commissioner of Inland Revenue [1997] HKLRD 924 at page 931.

66. The correct approach is stated by Bokhary PJ in Kwong Mile Services Limited v Commissioner of Inland Revenue (2004) 7 HKCFAR 275 as follows:

(a) The ascertainment of the actual source of a given income is a practical, hard matter of fact (paragraph 7).

(b) Judging the matter of source as one of practical reality does not involve disregarding the accurate legal analysis of transactions (paragraph 9). As Rich J said in the High Court of Australia in Tariff Reinsurances Ltd v Commissioner of Taxes (Victoria) (1938) 59 CLR 194 at page 208 (repeated in Federal Commissioner of Taxation v United Aircraft Corporation (1943-44) 68 CLR 525 at page 538):

> *'We are frequently told, on the authority of judgments of this court, that such a question is "a hard, practical matter of fact". This means, I suppose, that every case must be decided on its own circumstances, and that screens, pretexts, devices and other unrealities, however fair may be the legal appearance which on first sight they bear, are not to stand in the way of the court charged with the duty of deciding these questions. But it does not mean that the question is one for a jury or that it is one for economists set free to disregard every legal relation and penetrate into the recesses of the causation of financial results, nor does it mean that the court is to treat contracts, agreements and other acts, matters and things existing in the law as having no significance.'*

67. In Kim Eng, Bokhary PJ regarded it as well established that:

(a) Source is a practical hard matter of fact to be judged as one of practical reality (paragraph 56).

(b) Judging the matter of source as one of practical reality does not involve disregarding the accurate legal analysis of transactions (paragraph 52).

68. In ING Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue (2007) 10 HKCFAR 417, Ribeiro PJ said that one focus on effective causes without being distracted by antecedent or incidental matters:

> '*In Kwong Mile Services Ltd v Commissioner of Inland Revenue, applying the abovementioned authorities, this Court noted the absence of a universal test but emphasised "the need to grasp the reality of each case, focusing on effective causes without being distracted by antecedent or incidental matters."* [8] *The focus is therefore on establishing the geographical location of the taxpayer's profit-producing transactions themselves as distinct from activities antecedent or incidental to those transactions. Such antecedent activities will often be commercially essential to the operations and profitability of the taxpayer's business, but they do not provide the legal test for ascertaining the geographical source of profits for the purposes of section 14' (paragraph 38).*

Lord Millett NPJ could not accept the proposition that the source of the profits of one member of the group can be ascribed to the activities of another:

(a) Wardley[9] has been correctly decided. The taxpayer was acting as a fiduciary in investing its clients' funds. The sole basis upon which it was entitled to receive and keep for itself a negotiated rebate on commission paid to effect trades on its clients' behalf was the management agreement which it was performing in Hong Kong. It would otherwise have come under a duty to account to the clients for the rebated sums which represented a reduction in the expenses incurred in effecting trades on clients' behalf. What produced the profit was therefore performance of the contract in Hong Kong and not the effecting of the trades offshore (at paragraph 112).

(b) The operations 'from which the profits in substance arise' to which Atkin LJ referred[10] must be taken to be the operations of the taxpayer from which the profits in substance arise; and they arise in the place where his service is rendered or profit-making activities are carried on. There are thus two limitations: (i) the operations in question must be the operations of the taxpayer; and (ii) the relevant operations do not comprise the whole of the taxpayer's operations but only those which produce the profit in question (paragraph 129).

(c) It is well established in this as in a number of other jurisdictions that the source of profits is a hard practical matter of fact to be judged as a

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8 (2004) 7 HKCFAR 275 at 283G, per Bokhary PJ.

9 Lord Millett NPJ cited part of the passage cited in paragraph 64 above.

10 The judgment of Atkin LJ in FL Smidth & Co v Greenwood [1921] 3 KB 583 at 593.

practical reality. It is, in other words, not a technical matter but a commercial one (paragraph 131).

(d) His Lordship cannot accept the proposition that, in the case of a group of companies, 'commercial reality' dictates that the source of the profits of one member of the group can be ascribed to the activities of another. The profits in question must be the profits of a business carried on in Hong Kong. No doubt a group may for some purposes be properly regarded as a single commercial entity. But for tax purposes in this jurisdiction a business which is carried on in Hong Kong is the business of the company which carries it on and not of the group of which it is a member; the profits which are potentially chargeable to tax are the profits of the business of the company which carries it on; and the source of those profits must be attributed to the operations of the company which produced them and not to the operations of other members of the group (paragraph 134).

(e) In considering the source of profits, however, it is not necessary for the taxpayer to establish that the transaction which produced the profit was carried out by him or his agent in the full legal sense. It is sufficient that it was carried out on his behalf and for his account by a person acting on his instructions. Nor does it matter whether the taxpayer was acting on his own account with a view to profit or for the account of a client in return for a commission (paragraph 139).

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

69. In Commissioner of Inland Revenue v Datatronic Ltd [2009] 4 HKLRD 675, Tang VP stressed the importance of not confusing technical assistance given by a taxpayer as a profit-making transaction; that the charging section is section 14; and that DIPN 21 has no legal effect in the absence of some administrative law reason.

'*26. It was the failure on the part of the Board to concentrate on the profit-making transactions which resulted, with respect, in its wrong conclusion. The matter could be tested in this way. Suppose a company in Hong Kong sells raw material at cost to an unrelated factory in the*

Mainland so that they would be used by the unrelated factory to produce the product which, in turn, was sold to the Hong Kong company, which then sold the product in Hong Kong at a profit. Suppose the finished product was purchased by the Hong Kong company at $2 and then resold at $3, the profit of $1 would be attributable to its sale of the finished product in Hong Kong. Let us further suppose that to ensure the product's quality, the Hong Kong company not only supplied the raw materials at costs but had also posted a number of staff to the mainland factory to provide technical or other assistance as may be necessary. We do not believe that that would make any difference. Nor, for that matter, the fact that the mainland factory happened to be a wholly-owned subsidiary of the Hong Kong company, and as such the Hong Kong company was able to procure the wholly-owned subsidiary to sell its product to the Hong Kong company at cost.

27. In this context, it is necessary to bear in mind the observation of Millett NPJ in ING Baring Securities:

> *"134. … But I cannot accept the proposition that, in the case of a group of companies, "commercial reality" dictates that the source of the profits of one member of the group can be ascribed to the activities of another. The profits in question must be the profits of a business carried on in Hong Kong. No doubt a group may for some purposes be properly regarded as a single commercial entity. But for tax purposes in this jurisdiction a business which is carried on in Hong Kong is the business of the company which carries it on and not of the group of which it is a member; the profits which are potentially chargeable to tax are the profits of the business of the company which carries it on; and the source of those profits must be attributed to the operations of the company which produced them and not to the operations of other members of the group."*

28. We cannot accept the submission of Mr Chua, appearing for the Taxpayer, that the invoices and other documents showing that the transactions between the Taxpayer and DSC were by way of sale (it is sale of raw materials by the Taxpayer to DSC and the finished product by DSC to the Taxpayer), were only produced for customs purposes and were unreal. One might equally say that the internal documents relied on by the Taxpayer were prepared for the purpose of profits tax computation in Hong Kong and unreal. In any event, the Board has taken all relevant matters (including those internal documents) into consideration, and there is no basis upon which one could overturn its conclusion that DSC was not the Taxpayer's agent in the mainland, that DSC was manufacturing on its own account, and that DSC then sold its product to the Taxpayer.

29. With respect, the Board has confused the technical assistance provided by the Taxpayer as the profit-producing transactions.

30. The learned judge was of the view that the Board's decision to allow the Taxpayer's appeal must have been premised on DIPN 21. The Board referred in terms to paras. 20 and 21 of DIPN 21 which is quoted above. We do not believe paras. 20 and 21 are helpful. With respect to the Board we believe it has failed to properly apply Kwong Mile. The relevant profits were made on the sale of the products. The fact that because of the Taxpayer's connection with DSC it was able to buy the products cheaply or at cost would not change the nature of the transaction. Nor that because of its technical assistance DSC was able to produce products which the Taxpayer could sell at a profit.

31. …

32. The commissioner submitted that DIPN 21 does not have the force of law and is not binding on the board or the court. We agree the charging session is section 14, and that DIPN 21 has no legal effect. In any event, DIPN 21 does not apply to import processing as opposed to contract processing. We do not believe one is entitled to stretch the concession. Also, this is not a case where for some administrative law reason effect should be given to DIPN 21. No such reason has been advanced.

33. The learned judge then proceeded to construe DIPN 21 and he rejected the commissioner's argument, which he said was that:

> *"33. … because of the form chosen, the taxpayer was not involved in the manufacturing activities of DSC."*

34. DSC was the Taxpayer's wholly-owned subsidiary, but it was a separate legal entity and the fact that its dealings with the Taxpayer were not at arm's length would not detract from the reality of the legal effect of the transactions.

35. The assessable profits were generated by the Taxpayer selling the finished products bought from DSC. The Taxpayer did not make the profit manufacturing in the mainland. It does not matter that it was able to have the products manufactured cheaply in the Mainland because its wholly-owned subsidiary could be procured to do it at a rate which would result in more profit being made by the Taxpayer in Hong Kong. The manufacturing was done by DSC. The Board has so found and that is substance not form. The Taxpayer's activities in the mainland were merely antecedent or incidental to the profit-generating activities.

> *36. Mr Chua relied on the finding by the Board that the Taxpayer was a manufacturer. But the essential findings by the Board was that DSC was not the taxpayer's agent and that the manufacturing activities carried on by DSC were not the activities of the Taxpayer. Where, with respect, the Board has gone wrong, was to have failed to have proper regard to Kwong Mile and ING Baring when it mistook the Taxpayer's antecedent or incidental activities as the "profit-producing transactions". The profit-producing transactions were the purchase from DSC and subsequent sale by the Taxpayer.'*

70. In Commissioner of Inland Revenue v C G Lighting Ltd [2011] 2 HKLRD 763, Tang Acting HCCJ considered Datatronic indistinguishable and upheld the judge's conclusion that the sales to the taxpayer's customers were the profit-producing transactions.

> *'23. The Board has also found, correctly, and as accepted by the Taxpayer that, CGES was the manufacturer.*
>
> *24. On those findings, Fok J allowed the appeal and answered the questions posed in the case stated in the affirmative because:*
>
> *"102. I do not consider that this reasoning involves ignoring the cost structure of the Taxpayer, as submitted by Mr Barlow SC. The costs to the Taxpayer of acquiring the finished lighting products which it then sold to its customers are reflected in the processing fee paid by it to CGES. The fact that this processing fee was no greater than the operating costs and overheads of CGES would appear to be the result of a deliberate decision by the Taxpayer to structure the processing fee in this way. The fact that the manufacturer of the finished lighting products was its wholly-owned subsidiary is the reason why in practice the Taxpayer was able to achieve this. That, however, does not detract from the fact that the costs of acquiring the finished lighting products were taken into account in arriving at the profits earned by the Taxpayer from what I have concluded to be the profit-producing transactions in the present case, viz. the sales to the Taxpayer's customers.*
>
> *103. Nor do I consider that this analysis involves isolating one part of the Taxpayer's business and treating it as the whole of the business, a submission which Mr Barlow SC made by reference to Pinson on Revenue Law (17th Ed.) §2-11A. As the Board held and the Taxpayer accepted, CGES was the manufacturer and so the Taxpayer did not manufacture the lighting products which it sold for a profit. This does not involve isolating one part of the*

> *Taxpayer's business but instead the analysis seeks to exclude an activity which was held to have been undertaken by a non-agent third party, i.e. CGES. This approach is consistent, in my judgment, with the decisions of the Court of Final Appeal in Kwong Mile Services and ING Baring Securities."*

25. With respect I am in complete agreement with the learned judge.

26. Fok J further held that CIR v Datatronic [2009] 4 HKC 518 where the transactions between the Taxpayer and the manufacturer in the Mainland (a subsidiary) took the form of sales, was indistinguishable from the instant case. With respect, I also agree.'

The Board's decision

71. The Accountant made no application to amend any ground of appeal. The Appellant is bound by and confined to its grounds of appeal on giving notice of appeal. We will consider each in turn.

Ground (i)

72. The Appellant contended that it did not carry on a trade, profession or business in Hong Kong within the meaning of the Ordinance during the years in dispute. This is the first of the three 'Hang Seng conditions' which must be satisfied before a charge to tax can arise under section 14.

73. This is a question of fact[11] but the Appellant made no attempt to adduce any or any relevant evidence. The Appellant is not in a position to benefit from sparsity in evidence.

74. Further and in any event, the Appellant is a company incorporated in Hong Kong; acknowledged that it employed supervisory, management and other employees[12]; purchased the raw materials in Hong Kong[13]; and made deliveries from and accepted deliveries to Hong Kong[14]. The Appellant was registered under the Business Registration Ordinance, Chapter 310, and maintained a business address in Hong Kong. Moreover, the Appellant was at all material times a company incorporated for the purpose of making profits for its shareholders and put its assets to gainful use.

75. We find as a fact that the first Hang Seng condition was satisfied.

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11 See paragraph 61 above.
12 See paragraph 47(e) and (f) above.
13 See paragraph 49(d) above.
14 See paragraph 44(d) above.

Ground (ii)

76. The Appellant contended that its profits did not arise in or derive from Hong Kong within the meaning of the Ordinance during the years in dispute. This is the third Hang Seng condition. There is no contention in respect of the second Hang Seng condition.

77. Source of income is a 'practical hard matter of fact'. Bare assertions made in the course of the objection or by the Accountant at the hearing do not prove themselves.

78. The Accounting Firm contended that[15]:

> '[The Appellant] was engaged in the business of manufacturing of metal components and mould for the captioned years of assessment. All the manufacturing operations and activities were conducted [offshore] and hence all manufacturing profits derived therefrom are offshore sourced and not subject to Hong Kong profits tax.'

79. Manufacturing by itself does not generate any profit. A profit arises if, for example:

(1) the Appellant manufactured for another party at a fee higher than its costs of manufacture; or

(2) the Appellant sells goods which it makes at a price above its costs of manufacture.

80. These two versions appear different. Yet, the Appellant has put forward both versions at different times:

(1) It contended that Immediate Holding Company subcontracted part of the manufacturing process to its subsidiaries, including the Appellant. The Appellant acted as a subcontractor of Immediate Holding Company, manufacturing metal components and moulds [offshore][16].

(2) It also contended that employees stationed in Hong Kong were responsible for functions including 'processing of customers' orders'[17]. On version (1), there was only one customer, the Immediate Holding Company. Here we have 'customers' in the plural. In answer to the Chairman's question as to what the Appellant itself did to earn its profits, the Accountant said the Appellant manufactured products for sale to its customers. On the basis of what the Accountant said, the Appellant faces

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15 See paragraph 42(a) above.
16 See paragraph 40 above.
17 See paragraph 47(f) above.

> the formidable task of distinguishing this sale of goods case from Datatronic.

81. No attempt has been made to explain or reconcile the versions.

82. When requested by the Assessor in May 2006 to provide, inter alia, details of its operation and full sets of documents on the largest transactions for reference, the Accounting Firm advised that the information and documents requested could not be provided[18].

83. Source is a factual question. The burden of proof is on the Appellant. Inability to prove that the assessments appealed against are excessive or incorrect means that the appeal is bound to fail.

84. There is no evidence of any or any offshore manufacturing by the Appellant. There is no identification of the profit-making transactions. We were told practically nothing about sale to the Appellant's customers.

85. Much as an appeal tribunal dislikes deciding on the basis of burden of proof, in a case such as this, where there is not an iota of evidence of offshore manufacturing, we are driven to the conclusion that the Appellant has failed to discharge the burden of proof.

86. Ground (ii) fails.

Ground (iii)

87. The Appellant contended that the amount of profit is substantially less than the amount assessed by the Deputy Commissioner.

88. The Appellant has failed to prove that it undertook any offshore manufacturing. It has also failed to identify the profit-making transactions. Last but not least, it has failed to put forward any rational basis for apportionment.

89. Absent the factual premise, ground (iii) fails.

Ground (iv)

90. The Appellant contended that the Deputy Commissioner has failed to respect the spirit or letter of the Departmental Interpretation and Practice Note No. 21 and has therefore prejudiced the Company and other taxpayers acting in reliance upon such Departmental Interpretation and Practice Notes.

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[18] See paragraph 43 above.

91. It was held by the Court of Appeal in Datatronic that the charging section is section 14 and that DIPN 21 has no legal effect in the absence of some administrative law reason.

92. The Appellant has made no attempt to lay the factual foundation for any administrative law reason.

93. Further and in any event, as Hartmann J (as he then was) pointed out in Interasia Bags, the courts will not give effect to a legitimate expectation when to do so will mean that the decision-maker must act contrary to his statutory duties. The assessor is bound under section 59(1) to assess every person who is in the opinion of the assessor chargeable with tax under the Ordinance.

94. Caffoor is authority for the proposition that there is no estoppel arising from assessments in an earlier year.

95. In any event, the Appellant was not a party to any processing agreement.

96. Ground (iv) fails.

Ground (v)

97. The Appellant contended that the revised statement of loss and the additional assessments are incorrect, and that there is no other basis in the Ordinance that supports the revised statement of loss and the assessments.

98. Having failed to prove that the assessments appealed against are incorrect, ground (v) fails.

Conclusion

99. The appeal fails.

Disposition

100. We dismiss the appeal and confirm all the assessments appealed against.

101. Before we part with this case, we would like to record our thanks to Ms Chan Tak Hong for her helpful and pertinent assistance.