INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D152/01

Profits tax – source of income – securities trades.

Panel: Mathew Ho Chi Ming (chairman), Edward Chow Kam Wah and Thomas Mark Lea.

Dates of hearing: 13, 14, 17 and 18 July 2000.
Date of decision: 8 February 2002.

At all relevant times, the appellant company was a registered securities dealer in Hong Kong and belonged to a group of companies, Group B, dealing in securities globally.

The appellant company claimed that certain of its incomes, mainly commission, were derived outside Hong Kong.

The appellant classified the disputed incomes as offshore Hong Kong because the securities traded by its clients were executed and listed outside Hong Kong.

Held:

1. The Board found the most important services which enabled the appellant to earn commissions from its clients were research and sales undertaken by its Hong Kong office. Therefore the commission was sourced in Hong Kong (CIR v Hang Seng Bank applied).

2. The Board rejected the argument that the correct criterion for determining the disputed incomes was where the securities of client trades were executed.

Appeal dismissed.

Cases referred to:

Commissioner of Income Tax v Chunilal B Mehta of Bombay (1938) LR 65 Ind App 322
CIR v Hang Seng Bank Ltd 3 HKTC 351
CIR v TVB International Ltd 3 HKTC 468

CIR v Orion Caribbean Ltd [1997] HKLRD 924
CIR v Magna Industrial Co Ltd [1997] HKLRD 173
Overseas Containers (Finance) Ltd v Stoker (Inspector of Taxes) [1989] STC 364 (CA)

Gladys Li Senior Counsel instructed by Department of Justice for the Commissioner of Inland Revenue.
Barrie Barlow Counsel instructed by Messrs Kwok & Yih for the taxpayer.

Decision:

Nature of appeal

1. Company A was formerly known as Company B-HK ('the Appellant'). The Appellant is appealing against the determination of the Commissioner of Inland Revenue dated 31 July 1997 ('the Determination'). The Determination confirmed the profits tax assessment of the Appellant for the years of assessment 1990/91, 1991/92, 1993/94 and the additional profits tax assessment for the year of assessment 1990/91. The Determination further increased the profits tax assessment for the year of assessment 1992/93 and reduced the profits tax assessment for the year of assessment 1994/95.

2. This appeal relates to the question of whether the source of certain profits was offshore Hong Kong. The Appellant's offshore argument was that these profits were derived from the trading of securities listed outside Hong Kong by customers of the Appellant or customers of the Appellant's group of companies.

Background facts

3. The parties have agreed to a statement of agreed facts which essentially consisted of paragraphs 1(1) to (9) of the Determination and its appendices A to C. We set out as background information the first five paragraphs of the statement of agreed facts herein with some editorial changes.

4. On 24 April 1984, the Appellant was incorporated as a private company in Hong Kong. Prior to the year of assessment 1994/95, the directors of the Appellant regarded Foundation B, a company incorporated in Country 1, as being its ultimate holding company. Subsequently the Appellant was placed into administration. On 8th March 1995, Company C, a company incorporated in Country 2, acquired the majority of the companies in Group B either directly or indirectly. The acquisition included the Appellant. The directors of the Appellant have since regarded Company C to be the ultimate holding company. Although there is a slight overlap of the

Company C takeover date and the last tax period under appeal, Counsel for the Appellant submitted, and we accept, that Company C's takeover of the Appellant has no bearing on the facts of this appeal and our decision.

5. At all relevant times, the Appellant was part of a group (amongst other groups) within Group B of companies dealing in securities globally. This group is referred to as 'the Group'. The main holding company of the Group was Company B with offices in Cities 1, 2, 3, 4 and 5. A Group Chart was handed to us by one of the Appellant's witnesses which is appended to this decision as a reference to the corporate structure of the Group.

6. The Appellant was registered in Hong Kong as a dealer under the Securities Ordinance and its principal activity was to act as an agent in securities dealing.

7. In its profits tax returns for the years of assessment 1990/91 to 1994/95, the Appellant claimed that certain of its incomes were derived outside Hong Kong. The profits returned by the Appellant to the Revenue for assessment and the incomes claimed as offshore were as follows:

	1990/91	**1991/92**	**1992/93**	**1993/94**	**1994/95**
	$	$	$	$	$
Profits returned for assessment	32,957,451	13,839,658	75,305,049	127,438,074	27,678,658
Offshore incomes	26,086,970	40,966,000	33,480,000	40,351,435	25,255,605
Offshore sub-underwriting commission	156,379	2,539,423	8,994,129	--	--
Other offshore incomes *	--	--	6,841,946	--	--

* A table showing the 'other offshore incomes' for the year of assessment 1992/93 was separately attached as appendix A of the Determination.

8. The Appellant subsequently revised its offshore claims for the years of assessment 1990/91 to 1992/93. The revised figures were as follows:

	1990/91	**1991/92**	**1992/93**
	$	$	$
Revised profits offered for assessment	4,259,368	22,317,988	74,775,178
Revised offshore incomes	70,985,000	60,465,000	68,054,000
Offshore sub-underwriting commission	156,379	--	--
Other offshore incomes	--	--	6,841,946

9. The statement of agreed facts stated that the offshore incomes which were in dispute could be analyzed as follows:

	1990/91	**1991/92**	**1992/93**	**1993/94**	**1994/95**
	$000s	$000s	$000s	$000s	$000s
Placements	26,086	2,540	8,994	1,574	--
Commission	17,551	12,986	33,480	129,180	118,450
Marketing	86,986	80,745	69,782	27,012	91,200
Commission waivers	--	--	(1,659)	(1,421)	--
	130,623	96,271	110,597	156,345	209,650
Expenses	(59,638)	(35,806)	(42,543)	(114,850)	(184,678)
	70,985	60,465	68,054	41,495	24,972
Adjustments for expenses, depreciation and rebuilding allowances	--	--	--	(1,143)	284
Offshore incomes	70,985	60,465	68,054	40,351	25,256

Detailed breakdowns of the offshore incomes were attached as appendices B to B4.

The different categories of offshore income

10. The disputed offshore incomes are found in paragraph (5) of the statement of agreed facts (paragraph 9 above). This contained a breakdown of the disputed incomes down into four categories:

(a) Placements (and new issues) income ('Placements Income'),

(b) Commission ('Commission Income'),

(c) Marketing ('Marketing Income'), and

(d) Commission waivers ('Commission Waivers').

11. The fourth category of Commission Waivers were negative figures (or losses) for the years of assessment 1992/93 and 1993/94. According to a letter dated 19 November 1991 to the Revenue from the Appellant's then tax representative, Accountants' Firm D, Commission Waivers represented commission due from clients which were waived to maintain or foster client relationships. We have not been addressed on this fourth category by both parties. We have thus ignored Commission Waivers in this decision. We do note that if Commission Waivers were

waived income, we would have required evidence that the reason that it was in negative figures was due to a prior book entry which had booked the waived income as income (which was then subsequently waived). Otherwise, it would not have made any sense to have negative figures which would have reduced a taxpayer's income when in actual fact the actual income had neither increased nor decreased due to the waiver.

12. There were two additional categories of income not said to be in dispute. These were:

(a) The first additional category was the 'Other Offshore Incomes' for the year of assessment 1992/93 of $6,841,942 which consisted of various different types of income as set out in appendix A of the Determination and statement of agreed facts (and found in paragraphs 7 and 8 above). There were 15 types of 'Other Incomes'. Offshore claims were made in respect of seven out of these 15 types. Counsel for the Revenue was contented that this Board did not crack its head in relation to each of these separate Other Offshore Incomes and to treat them in the same way as Marketing Income. Counsel for the Appellant confirmed that this was the understanding between the parties and added that Other Incomes was not a separate item which needed to be addressed by this Board. We find the positions taken by both Counsel rather odd as, from the various types classified in Other Incomes, it was obvious that Other Incomes were mostly different in nature from the agreed disputed incomes. Although the total amount of Other Incomes claimed as offshore was small relative to the overall figure claimed in Placements, Commission and Marketing Incomes, the amount of $6,841,942 in quantitative terms was not insignificant. Given the clearly different nature of Other Offshore Incomes, we cannot treat them in the same manner as Marketing Income. No evidence and no submissions in respect of Other Offshore Incomes were submitted to us. The parties appeared contented that we need not deal with it. We have also ignored this type of income in this decision.

(b) The second additional category was the 'Offshore Sub-underwriting Commission' for the year of assessment 1990/91 of $156,379 (found in paragraph 8 above). There were incomes in this category for the years of assessment 1991/92 and 1992/93 but these were reduced to zero when the Appellant revised its offshore claims.

13. Appendices B (1990/91) to B4 (1994/95) of the statement of agreed facts and the Determination contained detailed breakdowns of the disputed incomes. While appendices B (1990/91) to B2 (1992/93) were in one type of format, appendices B3 (1993/94) and B4 (1994/95) were in formats different from appendices B to B2 and from each other.

14. Two areas to note in this appeal are the inconsistency of the categorization of the Appellant's incomes and the complete overhaul to the declared offshore income figures for the

initial three years of assessment 1990/91 to 1992/93. The overhaul in figures can be seen in the tremendous difference between the figures in paragraphs 7 and 8 above. The inconsistency of categorization can be seen in the appendices as follows:

(a) Seven types of incomes in appendix B3 (for the year of assessment 1993/94) were found. Three of these types paralleled the agreed disputed incomes of Marketing Income, Placements Income and Commission Waivers. The remaining four incomes were 'Commission and Dealing Income', 'Other Income', 'Net Dealing Interest' and 'Management Fees'. With a little arithmetic, one would see that Management Fees (which was in negative figures) was removed from the calculation to come to the total income of $156,345,000 for the year of assessment 1993/94. One would see further that Commission Income of $129,180,000 was in fact the sum of Commission and Dealing Income, Other Income and Net Dealing Interest. In the same way as we have noted in paragraph 12(a) (for Other Offshore Income for the year of assessment 1992/93), we find it odd that Other Income and Net Dealing Interest (which were obviously different in nature to Commission Income) could be treated in the same manner as Commission Income when considering their territorial source.

(b) Only two types of income in appendix B4 (for the year of assessment 1994/95) were found. These were 'Commission, Dealing and Other Income' which was the agreed Commission Income and 'Marketing and Management Income' which was the agreed Marketing Income. We have already queried why 'other' income should be slotted together with Commission Income. As for the 'management' aspect of Marketing and Management Income, the inclusion of management in the 1994/95 naming of Marketing Income was odd (especially when it had been specifically excluded in the prior year of assessment 1993/94 as mentioned in the preceding sub-paragraph).

15. Given the amount of the income under dispute and the tax implications, we would have expected more detailed or better categorization of the various incomes which could be vital in the determination of the source of profits of each different type of income. In a way, our task was made easier by the Revenue's agreement on the disputed income. But in another way, our task was made more difficult due to the nagging doubt of whether the categorization was sufficient.

16. The three disputed incomes which the parties have asked us to focus on are Placements Income, Commission Income and Marketing Income. One important element to bear in mind is the nature of the disputed incomes. The Appellant and the Group were securities brokers trading securities listed or to be listed in the various major global stock markets for and on behalf of clients of the Appellant and the Group. The disputed incomes were not profits earned by the Appellant in the trading of the securities. Any profits so earned belonged to the clients.

17. Placements Income appeared to be related to the commissions earned from clients in the purchase of new shares issued or to be listed outside Hong Kong. Commission Income and Marketing Income could be an allocation of the commission so earned from clients within the Group or commission earned from clients in the trading of securities listed outside Hong Kong. Counsel for the Appellant submitted that these two incomes be treated as the same.

18. We emphasize the distinction of the disputed incomes being based on either the commission earned from clients trading in securities or incomes between Group companies rather than from the Appellant trading in the securities. It is easy to blur this important distinction when considering the evidence.

19. Counsel for the Appellant submitted that the Privy Council case (on appeal from India in 1938) of Commissioner of Income Tax v Chunilal B Mehta of Bombay (1938) LR 65 Ind App 322 was practically indistinguishable from this appeal. The Privy Council had held that the profits earned by a Bombay commodities broker trading in commodity futures outside India were offshore India. There were two aspects of the broker's business. There was his speculation business in which the taxpayer traded on his own account and his brokerage business in which he traded on behalf of his constituents. It was the former aspect of the taxpayer's income that was the subject matter of the Mehta case. The incomes under consideration in this present appeal were not profits from trading of securities listed offshore. Hence the Mehta case is quite distinguishable from the facts under appeal.

Criterion used to classify an income as offshore

20. The criterion used by the Appellant in classifying disputed income as offshore Hong Kong was based on the country in which the securities comprised in a client trade was listed and traded by customers of the Group. Incomes derived from execution of client trades of securities listed outside Hong Kong were classified as offshore and the subject matter of this appeal. This was the criterion used when the Appellant declared its incomes and presented its case to the Revenue. And this same criterion continued when this Board heard this appeal.

21. One question which we will have to address in this decision is the propriety of equating the country where securities of a client order were traded or executed with the source of the three disputed incomes in this appeal.

22. Disregarding, for the moment, the propriety of the Appellant's criterion in determining territorial source of the disputed incomes, we note two peculiarities:

(a) The Appellant's application of this criterion was inconsistent. Given the amount of the income under dispute and the tax implications, we would have expected consistent application and more detailed classification if some income did not 'fit' the criterion. The format of appendices B to B2 was that of a table which showed

a breakdown of each of the three disputed incomes arising from client trades of securities in various Asian countries on a country-by-country basis. It was easy to relate these tables to the agreed disputed incomes in paragraph 9 above. Apart from the consistency of presentation in appendices B to B2, we set out the following inconsistencies.

(i) Appendix B2 (1992/93) showed an 'Other' country for Placements Income. Presumably it must mean some country(ies) other than those listed. But we fail to see why the country(ies) could not have been named.

(ii) The format of Appendix B3 (1993/94 – but actually for the period ended 31 December 1993 due to a change in the financial year end) was different. It was a reproduction of schedule G of the Appellant's tax return for the year of assessment 1993/94. It was not immediately apparent how the figures in appendix B3 could be reconciled with the agreed disputed offshore incomes for the year of assessment 1993/94 in paragraph 9 above. It could be seen that the country breakdown included places which were not countries but were rather the continents or regions of Europe and America. (We note two facts. Firstly, there was also mention of 'Austra [*sic*]' which we assume to be Australia or Australia and New Zealand. No income was attributed to Austra although there were expenses which must mean that somehow expenses as outlined in appendix B3 such as occupancy, communications, staff welfare, information services, reference and research, and others were allocated to the Appellant. Secondly, likewise, while Europe and America had no income, it had expenses allocated to these two regions as well.)

(iii) The format of appendix B4 (1994/95) was again different. This time, the breakdown was termed a 'products' breakdown and it was a combination of various countries and products. The 'products' were called 'HK Agency Derivatives', 'Structured Products', 'Funds' and 'Bonds'. We do not know what to make of these products and how they fit in or affect the determination of the source of profits.

(b) The markets referred to in the evidence and submissions in respect of the disputed incomes were the stock exchanges of Hong Kong, City 3, City 4, City 6, City 7, City 8, City 9, City 10, City 11, City 12 and Country 3. These were Asian equity markets. Curiously, client trades in securities listed in other major markets formed no part of the disputed income. This is peculiar since the criterion used by the Appellant was the stock exchange or market where the securities were traded. There was evidence presented to us stating that the Group acted for clients who traded in equity markets in the Far East, Latin America and other

emerging markets. We could not see why this was limited to the various Asian markets mentioned above. What had happened to the client trades in securities in Latin America and other emerging markets? Further, there was evidence presented to us of clients trading in equity markets other than in the Far East, Latin America and other emerging markets. It appeared that the Group also traded in the City 1 market as one of the Appellant's witnesses was from the Group's technology division and was adopting the automated client trade system in City 1 for the Asian markets. Still further, there was mention of America, Austra [*sic*] and Europe in the breakdown for the year of assessment 1993/94 (sub-paragraph (a)(ii) above) and there was also mention of America, Europe, New Zealand or Australia in the products breakdown for the year of assessment 1994/95 (sub-paragraph (a)(iii) above). Therefore one would have expected the evidence to show trading of client orders in markets other than the Asian markets shown to us. And logically the Appellant's income in respect of client orders from securities traded in these other markets would be part of the income listed as offshore. The answer may be that the Appellant was not used as the 'booking office' for trades in these other markets. This then begs the question of why the Appellant was used to 'book' trades only for the Asian markets if the intention is mere booking. Further, if the income were mere 'bookings', an explanation would be required of why there were these different categorizations of various incomes of commission, dealing, marketing, management, placement net dealing interest and other incomes seen in the evidence.

The issue to be decided

23. We have been asked by both parties to decide whether Placements Income, Commission Income and Marketing Income were profits of the Appellant which arose or were derived from Hong Kong from the Appellant carrying on a trade, profession or business in Hong Kong.

24. Counsel for both parties submitted that the dispute related to whether the three categories of disputed incomes were taxable in Hong Kong as a matter of principle and that there was no dispute on the quantum of the income. We have thus not addressed the issue from the quantum point of view.

The law – guiding principles

25. Counsel for both parties addressed us on the applicable law and there is little perceptible difference between them in the legal principles in dealing with extra-territorial tax claims; the difference being the weight that should be given to the evidence presented to us, whether the Appellant had discharged its burden of proof and how the legal principles should be applied to the evidence presented to us.

26. In considering the evidence and the submissions of both parties, we remind ourselves that section 68(4) of the Inland Revenue Ordinance ('IRO') puts the onus of proof on the Appellant as follows: '*The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.*'

27. Section 14(1) of the IRO, the charging section for profits tax, reads as follows:

> '*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.*'

28. Section 2 of the IRO defines 'profits arising in or derived from Hong Kong' as:

> '*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.*'

29. The common law has provided us with authoritative Privy Council decisions binding on us to clarify the difficult question of the territorial source of profits in CIR v Hang Seng Bank Ltd 3 HKTC 351, CIR v TVB International Ltd 3 HKTC 468 and CIR v Orion Caribbean Ltd [1997] HKLRD 924.

30. In the judgment of Lord Bridge in the Hang Seng Bank case at page 355:

> '*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 the section 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.*'

Counsel for the Appellant submitted that the second and third conditions described by Lord Bridge were not satisfied in this appeal rendering all three disputed incomes offshore and not subject to Hong Kong tax.

31. In the Hang Sang Bank case, Lord Bridge also stated the following at page 360:

> '*But the question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last analysis a question of fact depending on the nature of the transaction. It is impossible to lay down precise rules of law by which the answer to that question is to be determined.* ***The broad guiding principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profits in question.*** (emphasis added) *If he has rendered a service or engaged in an activity such as the manufacture of goods, the profit will have arisen or derived from the place where the service was rendered or the profit making activity carried on. But if the profit was earned by the exploitation of property assets as by letting property, lending money or dealing in commodities or securities by buying and reselling at a profit, the profit will have arisen in or derived from the place where the property was let, the money was lent or the contracts of purchase and sale were effected.'*

32. The guideline given in the Hang Sang Bank case was elaborated on by Lord Jauncey of Tullichettle who delivered the Privy Council judgment in the TVBI case at page 407:

> '***Thus Lord Bridge's guiding principle could properly be expanded to read "One looks to see what the taxpayer has done to earn the profit in question and where he has done it".*** (emphasis added) *Further their Lordships have no doubt that 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.'*

And at page 409:

> '*Their Lordships consider that 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. …and the examples were never intended to be exhaustive of all situations in which section 14 of the Ordinance might have to be considered.* ***The proper approach is to ascertain what were the operations which produced the relevant profits and where those operations took place.*** (emphasis added)'

33. Further clarification was made by Lord Nolan in another Privy Council case on appeal from Hong Kong: the Orion Caribbean case. At page 931, Lord Nolan stated that '*the ascertaining of actual source of income is a practical hard matter of fact*' and that '*No simple, single, legal test can be employed*'.

DIPN 21 – profits from trading or service fees

34. We were referred to the 1998 edition of the Departmental Interpretation and Practice Note No 21 ('DIPN 21') issued by the Revenue in 1992. We also had the benefit of having a copy of the 1992 edition of DIPN 21 with us although the submissions by Counsel for the Appellant concentrated on the 1998 edition. Nothing in this appeal turns on whether the 1998 or 1992 edition should be used. DIPN 21 was essentially issued by the Revenue to clarify the Revenue's interpretation of the two Privy Council cases, Hang Seng Bank and TVBI. It repeated the above general principles of law on which locality of profits is determined and on which we have based our decision.

35. Examples of how locality of profits was to be determined are found in paragraph 16 of DIPN 21 (paragraph 20 of the 1998 edition). '*Profits from the purchase and sale of listed shares*' and '*securities issued outside Hong Kong and not listed on an exchange*' were said to arise or be derived from the location of the stock exchange '*where the shares in question are traded*' or '*where the contracts of purchase and sale are effected*' respectively. This was the basis on which the Appellant had segregated its various income as onshore or offshore Hong Kong (as further analyzed below). But in our view this was an incorrect example to use. The Appellant was not trading in listed shares or securities. The disputed incomes were not profits from the purchase or sale of listed shares or securities.

36. The example on '*service fee income*' appeared to be the correct example to use in DIPN 21 for Placements and Commission Incomes. DIPN 21 identified the location of the such profits as '*the place where the services are performed which give rise to the payment of the fees*'. However, there was a suggestion from the Appellant that all the three disputed incomes were internal bookings of profits within the Group.

37. The examples in paragraph 16 of DIPN 21 are, in the final analysis, examples only. DIPN 21 is merely the Revenue's interpretation of the law published to assist taxpayers and their advisors. It is not part of the applicable law although it is extremely useful to taxpayers and their advisors to know how the Revenue interprets the applicable law.

Acts of others and of agents

38. Counsel for the Revenue pointed to CIR v Magna Industrial Co Ltd [1997] HK LRD 173 to emphasize that the focus is on the acts of the taxpayer and not of others. It was submitted that it was wrong to look at the acts of 'others' which included the executing entities (Group company or not) who executed the client trade in the relevant stock market in Hong Kong or overseas. We disagree. If the 'others' could be said to be agents of a taxpayer performing authorized acts on behalf of the taxpayer, then the acts of such 'others' cannot be ignored. The definition in section 2 of the IRO of 'profits arising in or derived from Hong Kong' expressly includes business transacted through an agent. The view of the Privy Council in the Orion Caribbean case was that a taxpayer is assessable to Hong Kong tax in respect of profits arising

from activities or operations of the taxpayer's agent which took place in Hong Kong. The Magna Industrial case showed how acts of agents may be treated as acts of the taxpayer. Thus acts of 'others' will be the acts of the taxpayer where the 'others' are agents of the taxpayer.

The evidence

39. At the hearing of this appeal, the following documentation was placed before us:

(a) Correspondence between the Appellant, its parent company (Company B) and the tax representatives of the Appellant (Accountants' Firm D and Messrs Kwok & Yih) on the one hand and the Revenue on the other hand.

(b) The profits tax returns of the Appellant for the relevant tax periods.

(c) Sample documentation in respect of the execution and settlement of client trades by the Appellant or the Group for and on behalf of their clients segregated by the seven countries (or stock markets) in which the securities were traded. The manner of segregation of the sample documentation by market was consistent with the criterion used by the Appellant to classify whether a certain income was onshore or offshore subject to the two peculiarities which we have noted. Much of the sample documentation related to the execution and settlement of the client trades. There was also written evidence of the allocation of commission income in the sample documentation.

40. At the hearing, three witnesses gave evidence for the Appellant. In their order of appearance, they were the following:

(a) There was Mr E, a chartered accountant involved in the financial control department of the Group from April 1992 to January 1994 and financial controller in Hong Kong between January 1994 and March 1997. He signed the Appellant's declarations in the tax returns for the years of assessment 1993/94 and 1994/95 declaring that the returns and the statements therein were true, correct and complete.

From him, we were given an idea of how commission income was allocated amongst various Group companies. He was also the main person who presented the numerous sample documents relating to the execution and settlement of client trades. It was obvious in his testimony that he was acting very much under the direction and instructions of the City 1 head office. In the preparation of the tax returns which he signed and in the correspondence between the Revenue and the Appellant and its representatives, Mr E acted more as a conduit pipe than as one who was capable of making or influencing decisions.

(b) There was Mr F who joined the Group in 1988 in City 1. He was with the Appellant as the head of information technology in Hong Kong from 1990 to 1996. From 1996 to 1998, he was the chief operating officer in Country 4. In 1999, he returned to Hong Kong as business manager for Asian equities.

He was responsible for taking the automated client trade settlement system in City 1 and developing it into an automated settlement system called 'System G' for the securities traded in the Asian stock markets. He was also part of the team which, in 1994, reviewed the client order and execution flows in the Asian Group companies to see if another automated system called 'System H', which was fully deployed in respect of securities traded in Country 5, could be extended to securities traded in other Asian markets. This review resulted in a long report practically authored by Mr F titled 'Report I'.

Mr F was also responsible for setting up systems to enable Group companies in Asia to transmit research products to City 1. He also gave us insight on the function of the research and sales which the Appellant viewed as more crucial than, or as crucial as, the execution function in respect of the agency brokerage business of the Group.

(c) There was Mr J who was the head of the securities' operations of the Group in Country 4 from 1989 to 1991 and in Country 6 between 1991 and 1992. He was based in City 1 for about half a year when in 1994 he became the head of settlement in Hong Kong until 1996. From 1997, he became the City 1 head of equities settlement. He provided us with further background information regarding the business nature of the Group and its general operations and shed further light on income allocation within the Group. He also provided collaboration to Mr E's testimony on the sample documentation relating to client trades in securities in the Country 4's and Country 6's stock markets. He had direct operational knowledge of these two markets for the periods under appeal. Further he gave evidence relating to Placements Income.

41. Given the time that has passed and the drama that has occurred in respect of the Group, we are sympathetic to the errors and inconsistencies that had cropped up in the testimonies of the witnesses. Further we appreciate the difficulty that may be experienced in procuring the proper witnesses who may have direct personal knowledge due to the passage of time. However, the onus of proof does rest on the Appellant. The Appellant had the statutory duty and should be well aware of the need to preserve records and any evidence (even if remotely relevant), especially when the tax returns had not been accepted and the offshore claims were the subject of detailed enquiries from the Revenue. While we accept much of what the witnesses have testified, it was also obvious to us that they were trying their best to present their testimony in the best interest of the

Appellant. They were evasive at times when confronted during cross-examination. Further due to the complexity of the subject under appeal and the manner in which they answered questions, there was ambiguity in parts of their testimony due to the imprecision of terminology used which was inconspicuous at first sight (or hearing) but which would be confusing especially after having heard and reviewed all the evidence.

Pre-Determination correspondence

42. It has not been easy making sense of the correspondence between the Revenue and the Appellant and its representatives prior to the Determination. The pre-Determination correspondence did not give a consistent picture. It appeared to us that this difficulty arose because of several factors:

(a) Part, or perhaps most, of the correspondence between Accountants' Firm D and the Revenue in respect of the Appellant's tax returns for the years of assessment 1990/91, 1991/92 and 1992/93 was produced to us by the Revenue. This set of correspondence commenced on 10 July 1991 and ended on 25 November 1994. The revisions of the incomes offered for tax for these three tax periods were contained in Accountants' Firm D's letter dated 14 April 1994 (which produced the revised schedules to claim offshore income and upon which the agreed schedules B to B2 of the Determination were based). Other than the profits tax returns for the remaining two tax periods of 1993/94 and 1994/95, no other correspondence between Accountants' Firm D and the Revenue relating to the last two tax years in dispute were produced. There might have not been any or for some reason, they were not presented to us. We have only the correspondence relevant to the first three tax years out of the total of five tax years.

(b) The Appellant or its tax representatives did not always answer the Revenue sequentially to the questions asked by the Revenue in the correspondence. Further the Appellant or its tax representatives had consistently failed to answer certain key areas resulting in appearance of the same type of questions repeatedly in the Revenue's correspondence. These unanswered questions related to human resources and operational or organization structure of the Appellant and interactions of the Appellant.

(c) Counsel for the Appellant pointed out several misstatements of fact in the pre-Determination correspondence covering the first three tax years and submitted that this was due to the time that had passed and the change of personnel at the offices of both the Appellant and Accountants' Firm D. Further between 1990 and 1997, all the landmark 'territorial source of profits' cases were being decided. It was submitted that these factors had added to the

confusion. Counsel for the Appellant submitted that these misstatements were a matter of history and the witnesses produced by the Appellant in this appeal were unable to assist this Board in clarifying how the misstatements were made.

(d) There were subtle differences in interpretation of the facts as presented by Accountants' Firm D in its correspondence. Other different interpretations were submitted by the Appellant at the hearing of this appeal.

(e) There were fundamental changes to the way that the Appellant was preparing its tax computations as could be seen by the scale of the modifications to the figures claimed for 'offshore income' in paragraphs 7 and 8 above for the first three tax years. This 'offshore income' constituted only part of the total offshore income claimed. The other offshore incomes which were not part of the 'offshore income' were the 'Offshore Sub-underwriting Commission' and the 'Other Offshore Incomes' in paragraphs 7 and 8 above. The 'offshore income' mentioned in paragraphs 7 and 8 above were the other categories of offshore incomes which were agreed to be in dispute as set out in paragraph 9 (being Placements Income, Commission Income, Marketing Income and Commission Waivers).

(f) In Accountants' Firm D's letter to the Revenue dated 14 April 1994, the 'Commission earned on Placements and New Issues' was described by Accountants' Firm D as 'sometimes be [*sic*] called Sub-underwriting Commission'. Thus it is not clear whether this Sub-underwriting Commission is the same as or different from the first category of disputed offshore income called Placements Income described below. Unfortunately this point was not spotted at the hearing of the appeal and the parties had no opportunity to make submissions on this.

Treatment of inconsistencies or errors in pre-Determination representations of facts

43. We cannot ignore the inconsistencies and the so-called misstatements of facts suggested by Counsel for the Appellant where there was no evidence presented to explain the inconsistencies and misstatements. We recognize that, at times, it may be difficult to differentiate between what was a presentation of fact and what was an interpretation of a fact in the pre-Determination correspondence. But our tax system depends on a taxpayer declaring and reporting accurate and true facts. This is why the burden of proof is on the taxpayer. There must be a presumption that the presentation of facts by a taxpayer to the Revenue was accurate and true. Where the facts are presented by tax representatives and not contradicted by evidence convincing us of any errors in the presentation of such facts, it must be assumed that the tax representative has acted in accordance with instructions from the taxpayer.

44. To ask the Board to ignore presentations of facts prior to the Commissioner making a determination will require evidence that what was presented to the Revenue as facts by the taxpayer was presented in error with explanations and evidence as to why the error occurred. If such evidence was not presented, convincing reasons on why such evidence could not be presented should be given. Otherwise, the credibility of the evidence presented to the Board in an appeal hearing which is contrary to prior presentations of facts would be severely tested. The explanations offered in this appeal (see paragraph 42(c) herein) were not evidence but submissions of Counsel. While Counsel's submissions are understandable, we do not ignore the facts presented and the 'misstatements' by Accountants' Firm D or Company B in the pre-Determination correspondence. In addition, the presentations of facts in the pre-Determination correspondence were made much closer in time to or even during the periods under appeal. Although they were not direct first hand evidence, they were more contemporaneous presentations than the presentations offered after the Determination or during the hearing of this appeal in the absence of evidence that they were wrong.

Business nature of the Group

Agency brokerage business

45. We set out in this section the facts relating to the business nature of the Group together with our comments thereon. Included in this section are further definitions of words to clarify meaning which are vital to the understanding of the evidence.

46. Bank B was a long established merchant bank in City 1. Company B was one of its principal subsidiaries and headed the international stock broking group or what we have defined as the Group. This Group specialized in equity markets. All Group companies in the Asian Pacific region were 100% owned subsidiaries except for Company B-Country 4 which was held 15% by a local joint venture partner (One witness mentioned that 20% was held by local Country 4's interests but this discrepancy is of no relevance).

47. The Group expanded in the Asian region by acquiring the Appellant, a Hong Kong securities business in 1986. The Group was then trading in the Hong Kong and Country 5's equity markets. The Appellant obtained its securities dealers licence in Hong Kong in about 1988 to 1989. Gradually, licenses were acquired by other companies in the Group to trade directly in the exchanges of City 7, City 12 and Country 3 during the periods under appeal.

48. The business of the Group was termed by the witnesses as the 'Agency Brokerage' business. It was the execution of client trades on securities listed in major global stock exchanges. Equities and securities are used interchangeably in this decision as are stock exchanges and equity markets.

Operational organization of the Agency Brokerage business

49. The Agency Brokerage business could be compartmentalized into three divisions (apart from the administration division) set out below. These divisions were generally applicable to the Group rather than specific Group companies (which we assume follows the same fundamental divisions where applicable).

50. What was conspicuously missing from the evidence was the specific organization structure of the Appellant itself. This would have been of great assistance to understanding the operations of the Appellant in Hong Kong and hence significant on the question of territorial source of profits of the Appellant. We were able to see some of the Appellant's set-up in the itemization of certain expenses reported to the Revenue (to be mentioned later). However, the Appellant had repeatedly failed to answer questions from the Revenue on organizational set-up of the Appellant in the pre-Determination correspondence and no evidence on this set-up was offered in the hearing of this appeal.

51. Be that as it may, the following were the three divisions of the Agency Brokerage business:

(a) The research and sales division ('Research' and 'Sales')

(i) Research and sales attract and obtain business from institutional clients and fund managers. They formed the bulk of the Group's clientele with the exception of some high net worth individuals. Research and Sales were regarded as important parts of the Agency Brokerage business. It was quality of research that clients were looking for in sourcing an Agency Brokerage service provider. The Group was on the top world rankings in research and sales in the Asian equities market. The witnesses believed, and we accept, that the Group's well-known reputation of high quality research was a prime reason for clients' patronage. Sales was the part that handled and liaised with clients regarding client orders to trade in securities.

(ii) Throughout this decision, 'client' means the client of the Group or one of the companies in the Group or the Appellant. For legal and taxation purposes, it would be too general and inaccurate to describe a client as being a client of the Group without knowing which company within the Group was the client a client of. There is virtually no evidence on how clients became clients. But some of the documents produced to us confirmed to us what must logically be true; that the clients were clients of a particular company within the Group. 'Client' would not preclude a Group company being the client when that Group company was executing what the witnesses termed as 'proprietary trades'.

(iii) 'Proprietary trades' were trades in securities in which the Group company itself purchased or sold securities. The disputed incomes did not relate to

proprietary trades although there were many instances in the sample documentation provided to us where it could be seen that a Group company was buying and selling securities with no client visible in the documents. We could only assume that these were undertaken by a Group company on behalf of clients or on behalf of another Group company which had contracted with clients to provide the Agency Brokerage service and that profits (or losses) from proprietary trades formed no part of any of the three disputed incomes since neither party raised any issues on proprietary trades.

(iv) 'Client order' means instructions from a client to any Group company to buy or sell certain securities listed or about to be listed on any major global stock exchange. 'Client trade' means a client's sale or purchase of the securities executed on the relevant stock market by a Group company and which had the requisite brokerage licence to trade in a particular market. Where the Group had no such capabilities in a particular equities market, 'client trade' means a client's sale or purchase of securities procured by a Group company through a third party licensed broker in that particular stock exchange. The client giving the client order may not necessarily be a client of the company executing the client trade in the market. The evidence suggested that where the client was not a resident of the country in which the securities of that client were traded, it was highly unlikely that the client was a client of the company executing the trade on the relevant exchange.

(b) The execution or dealings division ('Execution')

(i) Clients would place client orders at the Group 'sales desk' and the sales desk would pass the client orders along the Group chain to the execution or dealings division. 'Sales desk' or 'Group sales desk' appeared to be the Group company which took the client order. And, usually, it was the Group company located at the same place or country where the client was located or resident. This was not always the case as there were occasions when a client placed client orders directly with the execution office. But we were given the impression that this was an exception rather than the rule. The sales desk could be a section or department or group within a Group company in a certain location or city or country. For example, a Country 7 securities desk in the Appellant. The evidence did not suggest that the sales desk was a branch office or agent of the execution office. For example, the Appellant did not establish a branch office or representation office in Country 5 or in the office of the Group company in Country 5 (which was Company B-Country 5) to sell the services of the Appellant or to solicit or execute any client order relating to securities traded on the Hong Kong stock exchange. Hence it would appear (though not clear from the

evidence) that the sales desk was part of the Group company in which the client was situated or resident.

(ii) When the client would place a client order with a Group sales desk, we have no idea whether the Group sales desk was the Group company with whom the client had a contract for the provision of the Agency Brokerage service (viz the party legally obliged by contract to perform or arrange execution of a client order). We will refer to this entity as the 'Group Contracting Party'. We can only assume that the Group sales desk was either (1) the Group Contracting Party with whom the client had contracted to pay commission in return for the provision of the Agency Brokerage services to the client, or (2) the agent of the Group Contracting Party (that is, one Group company acting as agent of another Group company). Either way, it would be normal to assume that the Group Contracting Party was acting as principal vis-à-vis the client in the provision of the Agency Brokerage business.

(iii) The execution or dealings division would execute client orders to buy or sell securities listed or to be listed in the relevant stock exchanges. The client trade executed on the market was then allocated to a client order. There were various reasons for such allocation: consolidation of various client orders, market timings, the way a stock exchange operated, the size of a client order, the discretion granted to the Group in respect of individual client orders and the difficulty in synchronization of the client trade with 'real time' execution of client orders.

(iv) The place where execution was carried out was termed by the witnesses as the 'execution location' and the entity actually performing the execution function was termed 'execution location' or 'executing office'. 'Execution location' was the city or country in which the stock exchange of the securities to be traded under the client order was located. 'Execution office' or 'executing entity' was the office of the Group company at the execution location. The actual client trade was done by a Group company if there was Group company in the country of the exchange with the licence or regulatory approval to deal on the exchange. If not, then execution was carried out by a third party licensed dealer with whom the Group would place their client orders. If the Group then established a Group company and obtained the required brokerage licence for the relevant exchange, that Group company would take over the execution function from the third party licensed dealer.

(v) During the periods under appeal, the Group had not established a Group company in Counties 7, 8 and 9 to broker trades in the Cities 8, 9, 10 and

11 markets. It was not clear from the evidence whether the Group ever did establish a company or ever obtain the brokerage licence in Countries 6 and 10 to trade on the Cities 3 and 4 exchanges during the periods under appeal. Hong Kong and Country 5 were the only two markets in which the Group had a Group company (in the instance of Hong Kong, it was the Appellant) established with brokerage rights to trade on the Hong Kong and City 6 (capital of Country 5) stock exchanges throughout the periods under appeal. At different times within the periods under appeal, Group companies were established and became executing entities in Country 3 (October 1992), Country 11 (late 1990) and Country 4 (January 1991) for the Cities 7 (capital of Country 11), 12 (capital of Country 4) and Country 3 stock exchanges (with the Country 4's Group company not being wholly owned by the Group).

(vi) When the Group Contracting Party (or its agent, the sales desk) directed the client order to the executing entity, what then is the relationship between the Group Contracting Party (either directly or indirectly through its agent, the sales desk) and the executing entity? We bear in mind the possibility that the executing entity could be either a Group company or a third party non-Group company which could execute the client trade in the stock market concerned. Did the executing entity treat the Group Contracting Party (either directly or indirectly through its agent, the sales desk) as the principal or as the agent of the client in giving the buy or sell order? Whatever treatment was given, would this treatment be supportable in law? This issue would get much more complicated when we add in a possible further entity suggested by the Appellant in the equation; that of the booking office.

(c) The settlement division ('Settlement')

(i) Settlement of the client trade included confirmation of the client trade to the client, banking arrangements, custody of shares, transfers of money and delivery of the shares, bearing in mind the added complexity of involving different entities (client, and Group and non-Group companies) required in different countries when the client order was an order to trade in the stock markets outside the client's resident country or outside the jurisdiction where the client had contracted with the Group company for provision of the Agency Brokerage business. The Settlement division was the least important as it was pre-ordained by the client order and execution of the client trade.

52. There was another way of compartmentalizing the Agency Brokerage business, namely front and back offices. The front office comprised research, sales and execution (of client trades or proprietary trades). The back office comprised settlement of trades, finance and credit, regulatory and statutory reporting.

The significance of Settlement in generating income

53. The Appellant has submitted that the 'Settlement' or the 'back office' division of the Agency Brokerage business was consequential to the research, sales and execution or the front office. As such, the back office operations could not have been the economic source or origin of the profits of the Group or the Appellant. Thus, it was argued that the profits in respect of the disputed incomes of the Appellant did not arise out of nor were derived from the back office operations. However, this conclusion would be flawed without considering how large a role the Settlement department played in the Appellant's organizational set-up and how large a role the Appellant acting in a Settlement role in respect of Asian securities traded by clients of the Group played in the Group organization. If the majority or a substantial amount of expenses used to generate an income were related to the Settlement department of the Appellant or were related to the Appellant in the Settlement of the client trades of clients of various Group companies, it could not be said that the Settlement department of the Appellant or the Appellant acting as the Settlement division for Asian securities trades was not a significant factor which should be taken into consideration when considering territorial source of that income. There was hardly any evidence produced which would have given us the required information to consider if the Settlement department of the Appellant or the Appellant acting in its capacity as the Settlement division of the Group played a substantial or significant role in the generation of the disputed incomes. Hence, we are unable to weigh how important a role Settlement or the Appellant in its Settlement capacity played to earn the disputed profits.

The Execution or Settlement workflow and securities trading documentation

54. Much (if not, the majority) of Appellant's arguments and evidence concentrated on the Execution division of the Agency Brokerage business. We therefore elaborate more on this aspect of the evidence given.

55. Sample documentation relating to the execution and settlement of client trades in various Asian markets was placed before us. This constituted the bulk of the written evidence. We have attempted to summarize this evidence with our further comments (in addition to the comments in the text of this decision) in a second table also appended to this decision entitled Summary and Comments on Evidence on Workflow and Sample Trade Documents.

56. It should be noted that no documentation was provided to us in respect of any client order which a client placed with the sales desk in the sample documentation and workflow. The workflow commenced at the point where the sales desks, having received the client orders, passed

on the client orders to the Appellant or the Group company located in the market of the securities to be traded. The evidence suggested either (1) the client orders for securities to be traded in the Asian markets were passed on by the sales desks to the Appellant which were then passed on to the relevant Group company located in or near the market of the securities to be traded or (2) client orders were passed on simultaneously or nearly contemporaneously to the Appellant and the relevant Group company located in or near the market of the securities to be traded. The relevant Group company located in or near the market of the securities to be traded would then execute the client trade if it were an executing entity or it would ensure that a third party executing entity would execute the client trade in the market.

57. Mr E had the task of submitting the sample documentation on client trades in various Asian stock markets to this Board and given his financial background with no direct operational knowledge, he frankly admitted that his testimony on the sample documents was not based on personal knowledge (his knowledge being based on what could be deduced from looking at the documents or what he was told.) Despite this, he did his best to describe the nature of the income earned by the Group and how, as far as he knew, the income was allocated amongst various Group companies.

58. We set out in summary the testimony of Mr J, the only witness with direct personal knowledge of the operations and settlements of the Group at the relevant time.

(a) For clients located in Europe, the Group City 1 office has an Asian sales desk which took the responsibility for European clients trading in Asian shares. But Mr J (and the evidence of the Appellant on the whole) did not tell us which Group company or companies were the employers or the principal behind this Asian desk in City 1.

(b) Orders would be placed directly to the Group company in the execution location. Usually orders were placed by telephone if in overlapping time zones, and otherwise by fax or telex. The Hong Kong sales desk passed on the orders of its clients and, sometimes, clients of other Group offices in Asia. Other Group offices in the Asian region would also place orders directly to the execution location.

(c) From 1993, due to the System H computerization introduced in the Country 5 office, it became possible to automatically transfer trade orders to Company B-Country 5. Orders originating from the City 1 sales desk were in most cases booked to Company B. But some were booked through the Appellant due to value added tax ('VAT') positions of these clients.

(d) The Group company at the execution location would execute the trade in the market if it had the licence to do so on that exchange or through a local broker of

that exchange. The Appellant was responsible for execution on the stock exchanges in Hong Kong, Cities 8, 9 and Country 10. Company B-Country 3 was responsible for the Country 3, Cities 10 and 11 exchanges. Company B-Country 4 was responsible for the City 12 exchange. Company B-Country 5 was responsible for the City 6 exchange. Company B-International-City 3 branch was responsible for the City 3 exchange. Company B-Country 11 was responsible for the City 7 exchange.

(e) After the securities trade was executed in the market, the Group company with execution responsibility would relay verbal confirmation of the trade through the Group office through which the trade order was placed which in turn would inform the client. The verbal confirmation was supported by a hard copy. Mr J stated that the hard copy confirmation could be a direct arrangement by copying the trade confirmation which was issued by telex directly to the client. We take this to mean that the hard copy trade confirmation was given to the Group company placing the order but which could also be copied directly to the client. The issue of the hard copy trade confirmation was the primary step to initiate payment for or delivery of the securities traded by the client to the designated bank and custodian in the execution location.

59. Mr F provided a description of the trade order and execution mainly through his Report I. This report was the result of a review of the order or execution procedures in the Asian offices of the Group by Mr F and his colleagues with a view to implementing new applications and to improving the information technology systems for the undertaking of securities businesses on each Asian stock exchange. Report I was a snapshot of the order or execution process in 1994 rather than showing the process throughout the five tax years under appeal. This report gave us a summary of the workflow in respect of client trades from the perspective of a systems engineer. The first three letters in the name of Report I represented System K used to record house positions (viz proprietary trades) of the Group. The other three letters in the name of Report I represented System H. The workflow in Report I was divided on a country-by-country basis (all were Asian countries). It started with the transmission of the client order from the originating Group sales office (with some from clients directly) to the Group execution office responsible for the execution of a trade of securities in a certain Asian stock market. Report I did not cover trading in Country 5's securities. It also covered securities traded on the stock exchanges of Cities 4, 8, 9 and Hong Kong which were not covered by the country-by-country evidence of Mr E and Mr J nor were they mentioned in the pre-Determination correspondence. Countries 7 and 10 were part of the countries in which the disputed offshore incomes were categorized as could be seen from the agreed appendices B to B4. The workflow ended with the settlement system.

60. Although Report I was prepared from a technological system point of view, it was based on facts observed by its authors in respect of the client trade execution and settlement workflow in client trades involving securities traded in Asian stock exchanges. We have little

reason to doubt the facts as stated in Report I (despite minor errors). It corroborated the other evidence on execution and settlement of client trades. However, it lacked information to show how each Group company and the clients interacted and how client relationships were created as these elements were clearly not within its ambit of review.

61. Mr F also told us of the role played by the Appellant in the settlement process. The Appellant was said to be 'sometimes' used to support or facilitate settlement processing. Mr F's testimony was:

(a) The Appellant had settlement teams in the Countries 7 and 10 markets based in Hong Kong. Similarly the Appellant was used to coordinate settlement in respect of Countries 4 and 11.

(b) But for principal markets like Countries 3, 5 and 6, where execution offices were well established and had a high level of autonomy, the Appellant's role was limited to some back-office settlement support or facilitation in respect of the trades that were booked into the Appellant. The limited role would involve either receipt of faxed execution reports (for Countries 5 and 6 equities), or the receipt of computer data fed directly into the Hong Kong system for Countries 3 and 8 after October 1992. In both of these events, the Appellant would generate contract notes which were printed and sent to the client. Thereafter, the settlement activities of payment, and share delivery would be handled in the execution location by the Group company with the execution responsibility.

62. Some samples of documentation for securities clearing and custody services in several countries were provided in the Appellant's bundles of documents and mentioned in the second table. But these sample documents were related to clearing and custodial services provided by one Group company to another Group company. In so far as custodian services between the real client and the relevant Group company was concerned, it would appear that the client had an option of whether to require custodian services under clause 2 of the customer account agreements or customer agreements that are mentioned in paragraph 76 herein.

The Research and Sales division

63. Out of the three main divisions of the Agency Brokerage business, the Appellant submitted that the Research and Sales division and the Execution division were considered as the most important with the role of Sales being pivotal. The important role played by Research and Sales was said to be exemplified by how the Group allocated bonuses. According to the Appellant, after the biggest bonus going to top management who were from sales background, the next biggest bonus went to the top sales people and the researchers. We are not sure if allocation of bonuses would be the correct measure of the importance of the divisions. If it was, then the administration which had the highest bonuses would be considered as pivotal. In a manner of speaking, it was. A body cannot be said to be fully functional without the brain. From a Hong Kong tax source of profit point of view, the place where a business was administered is certainly one factor which should be taken into consideration. But it is not the only factor in determining what a taxpayer has done to earn its profits.

64. Was the Research and Sales division as important as the Execution division as part of the evidence suggested or was the Research and Sales division more important as other parts of the evidence suggested? Given that the Execution division of the Agency Brokerage business could have been handled by a third party independent of the Group, it would be logical that the Research and Sales division was more important. The Group could have instructed any duly licensed broker to execute a client trade for a particular security in a particular market. It did, where the securities in a client order were in a market in which the Group had not obtained the requisite regulatory licence to deal in that market. Thus, the Execution division could have been 'subcontracted' to other entities. The Group Contracting Party legally obliged to provide the Agency Brokerage service to the client would subcontract the 'Execution' aspect of the business to a broker which had the licence to deal directly in the market and this broker could either be a company within the Group or a third party not related to the Group at all.

65. The Research and Sales division may have been one division of the Agency Brokerage business, but they are two entirely different matters. We would address them separately.

<u>Research</u>

66. The witnesses testified to the importance of Research and the following two documents were produced:

(a) An article on stockbrokers' poll in the October 1995 edition of a magazine called 'Magazine L'. Between July and September 1995, Magazine L polled over 450 fund managers who invested in Asia Pacific equities. 129 institutions sent in a total of 141 replies. The timing of the poll and the publication of its result was just after the last period under appeal. We would consider the survey relevant to the periods under appeal. The institutions polled were the targeted clientele of the Group's Agency Brokerage business. These clients ranked their securities brokers in four categories of: overall research; specialist research

(macroeconomics, sectoral analysis, technical analysis, local contacts, blue coverage, stake picks, buy-sell calls and earnings forecasts); sales and back office. The result of this annual poll showed the Group being ranked overall number 2 (it was number 1 in the 1994 poll). We note that the institutions polled were not asked which of the four categories were perceived by them to be important; that is, they did not rank research as more important than the other categories. The methodology chosen by Magazine L placed the emphasis on research. But the fact that Magazine L used this methodology was indicative of the importance of research as a selection criterion in a stock brokers' beauty contest.

(b) The Group paid for an annual survey on equity brokers reported by Report M. It was considered as an authoritative market report for equity brokers such as the Group. Annually, Report M conducted interviews with fund managers and traders at large investing institutions (the Group's clientele) in Country 1 and Continental Europe. The Report M survey produced to us was the one for 2000 with statistics also for 1999 and 1998. It was based on 56 interviews with fund managers and 24 interviews with dealers in Country 1 for Asian shares. Again, like the article in Magazine L, the methodology employed in the survey was such that the interviewees were asked to evaluate the sales, research and trading services they received from their equity brokers in Country 1. This methodology was also indicative of the important roles played by sales, research and trading services (or as termed by Counsel for the Appellant, dealings and settlement).

67. Mr F described to us the importance of research. To him, it was the core element. The following was his testimony on research. Between 1990 and 1995, the Group's reputation and strength in a fundamentals based research brokerage was such that it was considered a leading broker of the Asian markets. The Group's Asian markets research product was highly regarded. The research was undertaken by analysts based in each market. The research publications each on different markets were distributed to clients and were used primarily by sales desks as reference and selling material. Stock market reviews were produced quarterly or semi-annually with data conveyed to City 1 for editing. All research was printed in Country 3. The Group execution offices had sizeable research teams usually larger than the sales staff. Apart from producing market information, analysts would have daily telephone conference meetings (one for local time and the other for City 1 time) for the Group's staff to call in and receive market updates.

68. Questions pertinent to the source of profits arise from looking at research as an important element in the creation of the Appellant's profits. All else being equal, could it be said that the research teams in different countries contributed equally to attract Agency Brokerage business to the Group? Alternatively should there be some apportionment amongst different countries' teams as to how much each contributed to the Group's research? If the apportionment between different research teams are agreed or could be reasonably accurately ascertained, the

next question was how much did Research on the whole contributed to the attraction of business to the Group?

69. We are unable to answer these questions satisfactorily based on the evidence given to us. However such questions need not be answered. From the written documents, we are able to ascertain that there was already a system in place for the allocation of research costs amongst the Group. In describing generally how booking for trades was made by Mr F and Mr J, allocation of research costs was not amongst the considerations (unless it could be considered as part of the overall fiscal strategy). However, there was some evidence of some strategy in this regard. Mr E had testified that since the Appellant was recharged the cost of research on the Country 9 market, 50% of the net commission from Company B (including Cities 1 and 2 offices) was also allocated to the Appellant. After 1994, Country 3 paid the Country 9 research costs and as a result the shared commission attributable to Cities 1 and 2 clients was passed through the Appellant to Company B. Was the 'recharging' of Country 9 research described above a specific isolated incident or part of an overall global research reallocation strategy? There was evidence of other allocation of research costs.

70. Further evidence of some sort of Group allocation of research costs could be found from the documents and is summarized as follows:

(a) Management fees were booked as an expense account in the tax returns of the Appellant for all the five periods under appeal. Schedule N (for the year of assessment 1990/91), schedule O (for the years of assessment 1991/92, 1992/93 and 1994/95) and schedules G and O (for the year of assessment 1993/94) each contained breakdowns showing 'research and management fee paid to' Group companies in Countries 3, 4, 9, 10, 11, Company B-Research and Company B-Management Services (there was no other evidence to tell us what these two companies were). The amounts paid were not insubstantial ($19,800,000 for the year of assessment 1990/91, $25,400,000 for the year of assessment 1991/92, $25,050,000 for the year of assessment 1992/93, $37,000,000 for the year of assessment 1993/94 and $6,900,000 for the year of assessment 1994/95). For the year of assessment 1994/95, the Appellant received research and management fees from the Group companies in Countries 1 and 10 and Company B-Overseas in the sum of $45,900,000.

(b) Accountants' Firm D's letter dated 14 April 1992 stated in paragraph 20 therein that for the years of assessment 1990/91, 1991/92 and 1992/93, various 'research and management fees had been paid' to Group companies in Countries 4, 10, 11 and two companies by the names of Company B-Research and Company B-Management Services. The said letter also stated that with the exception of the payment to Company B-Management Services, all the research and management fees 'relate to research on overseas markets'.

71. The evidence on allocation of research costs is incomplete and a comprehensive scheme (if it existed) could not be ascertained. There was no evidence of how the costs of research in the Asian markets were allocated to or compensated by the Group companies in Europe and North America. There is no evidence to say that research of the equities market of one country was undertaken by the Group company responsible for execution of trade in the equities of that country. A different company may be used. There was the Company B-Research above mentioned. Other companies may be used. Further the research company undertaking the research of the equities of a certain market might not have even been a company incorporated in the country of that market. One possible example was a subsidiary of the Appellant, Company B-Research-Country 10, doing research for the Country 10 market. This is deduced from the Group's sub-group chart produced by Mr J.

72. In the five tax years, the Appellant had paid research and management fees. Only in the year of assessment 1994/95 did the Appellant receive research and management fees. There is the interesting question of whether this income (accounted for as a negative expense item in the profit and loss accounts) was taxable in Hong Kong. That is another matter.

73. The evidence may be inadequate to paint a complete picture of 'allocation' of research expenses (or compensation or fees payable from one Group company to another for research). But there is sufficient material for us to conclude that if the Appellant was earning Client Commission (paragraph 117(b) below refers) from equities traded on offshore exchanges of its Hong Kong based clients, and if we were to hold that Research in offshore markets was an important element in earning any Client Commission earned from any client trades in the particular markets researched, we would have placed much less weight, or even ignored, the offshore research in considering the territorial source of Client Commission. The reason for this would be because the Appellant had already paid for the offshore market research which it had used in Hong Kong to procure business and generate profit from its Hong Kong based clients. If the Appellant had paid to another Group company fees for research done by that Group company on foreign markets and such research had helped the Appellant obtain contracts for Agency Brokerage business from clients to trade in securities in those foreign markets, such research expense would have been deductible as an expense which earned Client Commission paid by these clients to the Appellant. Also if the Appellant was earning research income for research done by the Appellant on the Hong Kong market which was then 'sold' to other Group companies so that they could procure business and generate profit from their clients in trading in Hong Kong equities, it would not be difficult to conclude that such income was earned by the Appellant and as the research was done in Hong Kong on the Hong Kong market, it was earned in Hong Kong.

Sales

74. Mr F testified to the following in respect of Sales. During 1990 to 1995, approximately two-thirds of the Asian Agency Brokerage business of the Group was generated by sales effort in

the Cities 1 and 13 offices. The Asian sales desk of Company B in City 1 undertook the European originating trade orders. Company B-City 13 undertook the North American originating trade orders. For Asian clients (including fund managers based in the Asian region, which were mostly in Hong Kong or Country 3), the sales effort (represented by the stock market reviews) was undertaken by Countries 3, 6 and Hong Kong offices. It was not uncommon practice for clients to be contacted by sales or research staff from these locations directly. When a client placed the trade order, the order would be placed with the Group's staff who had the client relationship. The Appellant had no Hong Kong based staff dedicated to the Country 5 equities market and orders would generally be placed by the client directly with the City 6 sales staff or through System H (but Mr F's assertion in this regard contradicted the testimony of Mr E who said that the originating sales desk places the order to Company B-Country 5). Mr F said that there was sales capability in Hong Kong for the Countries 3, 8 and 9 markets. For the Country 6 market, such capability existed in Hong Kong after 1992 in the form of one person called Mr N who handled Country 11 trades as well. (Mr F did not mention who employed such sales staff and whether they handled clients from Hong Kong only or clients from other countries as well irrespective of the countries of the equities traded).

75. Despite the Appellant's argument that research and sales were as important as execution of clients trades, the circumstances and documentation relevant to the creation of the sales and the entering into contractual obligations between the Group Contracting Party and clients were virtually ignored in the evidence. Due to the paucity of the evidence relating to what had transpired between the clients and the Group and the concentration of the evidence relating to execution and settlement, we have little idea of the relationship between the Group Contracting Party and its clients and the relationship between various Group companies in the workflow relating to the receipt and passing on of clients orders to the executing entity. We were not sure whether Commission Income could be the commission paid by the client under an Agency Brokerage service provision contract or the commission paid to an executing entity or whether they were same. We were never sure to any degree whether the client was directed to pay Client Commission to the Group Contracting Party which contracted with the client, to the Group company to which the sales desk of that client belonged or to the executing entity or the booking entity or to any other entity nominated by the Group. The suggested treatment of Commission Income and Marketing Income as the same type of income did not help in this regard.

76. There were some contracts with clients from the evidence submitted to us. In the Appellant's bundle of documents (bundle II) relating to Countries 3, 8 and 9, there were various documents described as client registration form with the terms and conditions of a customer account agreement (herein called 'Client Agreements'). These all had essentially the same wording. There were two major types of Client Agreements provided to us:

(a) There was one type of agreements which was a contract between a client as the client on the one hand and either Company B-Country 3 or the Appellant as the Agency Brokerage service provider (in other words, the Group Contracting

Party) on the other hand. In the sample documentation provided, such clients included Company O, Company P, Company Q, Company R, etc.

(b) There was a second type of agreement which was a contract between a Group company as client on the one hand and either Company B-Country 3 or the Appellant as the Agency Brokerage service provider on the other hand. In this second type of Client Agreement, the client was a fellow subsidiary or group company acting as a client vis-à-vis the service provider which was another company within the Group. Such clients in the sample documents included the Appellant, Company B-City 13, Company B-Options, Company B, City 1.

77. In the drafting of most of the Client Agreements produced to us, the 'securities' that the client was purchasing or selling through the broker were not defined. However, a definition can be found in one Client Agreement. In the Client Agreement dated September 1994 between the Appellant and Company S dated 23 February 1995, the word 'securities' was defined to include any shares, stocks, debentures, loan stocks, funds, bonds, or notes and any rights, options or interests in or in respect of any of the foregoing, certificates of interest or participation in, or temporary or interim certificates for, receipts for, or warrants to subscribe to or purchase any of the foregoing, or any instrument commonly known as securities. It is noted that the definition of 'securities' was not confined to securities of any single country or jurisdiction. Indeed a letter dated 11 January 1991 from Company B to Company O as client enclosing the client registration form between Company B-Country 3 and Company O showed the securities which Company O was trading using Company B-Country 3 as the broker were Country 9 securities. Hence the securities that a client could ask the Group Contracting Party to arrange to trade in the relevant market could be securities listed in markets other than the home market of the client or the home market of the Group Contracting Party.

78. We note that there were no similar Client Agreements in the bundle of sample documents for Countries 5 and 6 (bundle III) and for Countries 4 and 11 (bundle IV).

79. The Client Agreements were not particularly highlighted to us nor were the witnesses questioned on them. Did all clients of the Appellant signed Client Agreements with the Appellant? Did these clients then trade in Hong Kong securities and offshore securities? Did clients of other Group companies whether in or outside Hong Kong sign similar Client Agreements? On the face of the sample Client Agreements, it is unclear where the documents were executed, where the negotiations for the agreements took place and where the client was resident. The entire circumstances relating to how clients became clients, how the commission paid by these clients pursuant to the Client Agreements related to Placements, Commission and Marketing Incomes were not in the evidence.

80. As sales was an important element in the Agency Brokerage business, facts which related to the questions posed in the preceding paragraph would be important relevant facts which

would be required to determine the territorial source of the disputed income. The place where the sales took place, the place where the client contracted with the Appellant, the governing law of the contract, the place where the client placed the client order, the place where communications with the client occurred, where the client initiated payment of Client Commission, the instructions given to the client as to the method of payment and similar issues would be important areas to be addressed when looking at the locality of the profits produced as a result of these sales and contracts signed with clients. Legally, the commission that is paid by clients pursuant to Client Agreements would be Client Commission to the Group Contracting Party.

Placements Income

81. Out of the four categories of disputed income, there were only three categories which were presented to us in this appeal. Commission Waivers were ignored. Out of the three categories, the Appellant's case appeared to be that there were, in essence, two categories: Placements Income as one type and Commission Income and Marketing Income (which were submitted as similar) as the second type.

82. Placements Income was submitted to be commission earned on placements and new issues of securities on overseas stock exchanges in Countries 3, 4, 7, 8, 10 and 11. According to the pre-Determination correspondence of Accountants' Firm D, the Group offices all over the world would refer orders received from their clients to the Appellant. The Appellant consolidated the orders (including those from Hong Kong clients) and transmitted these orders to the overseas locations for execution (Accountants' Firm D's letters dated 19 November 1991 and 14 April 1994). There was no agreement between Group overseas offices and the Appellant. Allocation of commission to the Appellant was a matter of group policy. No commission was payable unless a transaction occurred (Accountants' Firm D's letter dated 16 April 1992). Accountants' Firm D provided a schedule of the offshore placement and new issues commissions for the year of assessment 1990/91 breaking down the offshore commission derived from Hong Kong and overseas clients (as schedule D of the Determination).

83. Out of the three witnesses, only Mr J testified specifically on Placements Income. He described that another and different group companies belonged to Bank B was involved in corporate financing, capital markets and banking activities. The relevance of this other group of companies is the underwriting that this other group undertook for new securities issues or placements. The Appellant was involved in the activities of this other group in two ways:

(a) The Appellant would procure local and overseas investors to subscribe for securities and bond issues which Bank B and other Group companies were underwriting in the Asia region.

(b) The Appellant would also undertake the selling of certain holdings of securities in connection with such underwriting by the other B group.

84. Mr J also described the process of how the Appellant was involved. 'At the time of new issue or placement in markets in the Asian region, the Appellant would generate orders itself from Hong Kong clients and receive orders referred from Group offices worldwide and would pass on orders for execution to the Group regional company where the security was being issued. The Appellant would receive a commission for the successful placement of the overseas issue with an overseas client'. Documentation evidencing the above transaction procedure was to be in the bundles to be supplied to us. Our attention was not drawn to any part of the bundles of documents supplied to us that was relevant to Placements Income. The bundles appeared to relate to the trading of securities in the relevant stock exchanges and did not refer to any placements or new issues.

85. Placements Income may apply also to commission received for Country 6's securities dealings prior to 1992. The connection is not clear. Mr J mentioned that prior to 1992 (before the Country 6's market opened up to foreign investors) Country 6's income generated was in the nature of placements and IPO fee received from both the Country 6's institution and from a transaction based commission based fee from the foreign investor. This being the case, we would have expected that the income for Country 6 would have been under the Placements Income column in the country breakdown in appendices B and B1 of the Determination for the first two years of assessment under appeal 1990/91 and 1991/92. But this column showed zero income. Instead, for Country 6, the Appellant reported only Marketing Income for both tax years. There raises the query of whether the Appellant had correctly categorized the incomes for the year of assessment 1991/92 which seemed to be Placements Income rather than Marketing Income.

Commission and Marketing Incomes – same or different?

86. While separately categorized in the Appellant's tax return, we have been asked to consider the Commission and Marketing categories as one and the same. The evidence does not suggest that they were the same.

87. Mr E's version of the commission allocation policy was marred by a possible confusion which we have described when we gave a brief outline of his testimony in the second sub-paragraph of paragraph 40(a) above. But Mr E was quite certain over the course of his evidence that Marketing Income was income reflected in various agreements between Group companies to which references will be made on in this decision and where we will define them as 'Intra-Group Commission Agreements'. According to Mr E's evidence, there was a distinction between Commission and Marketing Incomes.

88. Further, the pre-Determination correspondence suggested that Marketing Income and Commission Income were very different:

(a) According to Accountants' Firm D in its letter dated 19 November 1991, under the section titled 'Other Commission and Marketing Income', Marketing Income was specifically singled out to be the rebate to the Appellant of 50% of the commission charged by Company B-Country 5 (for Country 5 equities) and by Company B-Country 3 (for Countries 3, 8 or 9 equities) for executing transactions in the relevant exchanges in accordance with internal Group arrangement.

(b) Furthermore, in the same letter dated 19 November 1991, under the same section for Country 6, Marketing Income was also singled out to be the allocation to the Appellant of 50% of the commission income accruing to Company B-City 1 on Country 6's trades. This was also stated to be in accordance with group policy but which subsequent evidence suggested was a different sort of group policy due to the peculiarity of the Country 6's securities market.

(c) According to Accountants' Firm D's letter dated 14 April 1994 to the Revenue:

(i) Commission was the difference between the commission charged to clients by the Appellant and the commission charged by overseas brokers to the Appellant; and

(ii) Marketing Income was the result of the Group policy of splitting commission between the parties executing the transaction and introducing the clients. Marketing income was the Appellant's share of the commission earned by the overseas broker while marketing expense was commission paid by the Appellant to a fellow group company for introducing the client to the Appellant.

(d) According to Company B's letter to the Revenue dated 25 November 1994, Marketing Income for the Country 5 business was somewhat different. It was the rebate of half of the normal commission rate booked through non-Country 5's affiliated brokers which was allowed under Country 5 regulations. Marketing Income for Country 6's business was a bit more complicated. It was to compensate the Appellant for employing the Group's key executive handling Country 6's products. This executive was employed by both the Appellant for his services in the Far East and the Group Company in City 1 for his services in Country 1 but Company B-City 1 booked all the transactions resulting from his marketing activities. Hence the Appellant was compensated by City 1 paying to the Appellant 50% of the total income generated by that executive. This Country's Marketing Income was governed specifically by the Company B-Country 6's Securities Service Agreement 87 (hereinafter mentioned).

89. Thus we are of the view that Commission and Marketing Incomes are different. Mr E clearly made this distinction. No evidence was offered as to why the distinction was made in the tax returns and why Accountants' Firm D and Company B had made the distinction in their correspondence with the Revenue with quite specific reasons for the distinction being given as well.

90. One point to note in the pre-Determination correspondence set out above is the mixing of the commission payable to the executing entity, the commission charged to clients and the 'allocation' of commissions between Group companies. In our view, this was a source of confusion as all these three types of payment or charges were completely different in nature from each other. This mixture was also the source of the confusion resulting in the suggested treatment of Commission Income and Marketing Income as the same.

Group companies and booking of profits

91. Counsel for the Appellant pointed to Overseas Containers (Finance) Ltd v Stoker (Inspector of Taxes) [1989] STC 364 (CA) and the Orion Caribbean case and submitted that when considering the involvement of a taxpayer belonging to a group of companies in transactions involving other companies from which receipts arise, in tax law, regard must be had not only to the position of the taxpayer but also to the position of the group which owns the taxpayer. We accept this submission.

92. The Overseas Containers (Finance) Ltd case was the prelude to the submissions from Counsel for the Appellant on the non-taxability of profits which were submitted to be merely 'booked' or 're-invoiced' to a taxpayer. In this English Court of Appeal case, the taxpayer was a company interposed between its parent company and a third party financier so that the currency of the loan borrowed by the taxpayer from the third party financier was different from the loan granted by the taxpayer to its parent company and the interest paid by the taxpayer for the financing was higher than it would have been if the parent company had obtained the financing directly. The taxpayer claimed tax deductible losses arising from foreign exchange differences. Sir Nicholas Browne-Wilkinson V-C delivered the English Court of Appeal judgment. His view was that the sole question under appeal was whether the transactions under appeal constituted 'trading transactions'. For him, the only issues of law were whether it is relevant to take into account a fiscal purpose for which an alleged trading transaction was entered into and, if so, what is the effect of the existence of such a purpose. He was of the view that the authorities indicated that for transaction to be viewed as 'trading', it must have a commercial purpose. At page 269, he said '*If, on the other hand, the sole (and I emphasize the word "sole") purpose of a transaction is to obtain a fiscal advantage, it is logically impossible to postulate the existence of any commercial purpose*'. It was in the context of the group of the companies to which the taxpayer belonged that the fiscal purpose of the loan transactions could be seen. Thus Sir Nicholas Browne-Wilkinson V-C had '*no doubt that in such a case regard has to be had to the overall fiscal purpose of the group and the impact of its implementation on the group*' (at page 370). Looking at the taxpayer in isolation from the group, the commercial gain of the taxpayer was obtaining the interest

differential. But correctly viewed from a group angle, he concluded that the loans were not genuinely commercial and had no commercial justification. We would find this case as persuasive, though not binding in Hong Kong, for the proposition that if a transaction was undertaken by a taxpayer for the sole purpose of obtaining a fiscal advantage and not a trading transaction, any profits arising were not taxable as trading profit and that in looking at the purpose of such a transaction, the overall group of companies to which a taxpayer belongs can be taken into consideration.

93. Paragraph 7(g) of the 1992 edition of DIPN 21 set out the Revenue's view on the locality of profits from trading in commodities. It stated that where a Hong Kong business was not in direct contact with an overseas supplier and customer and no sale or purchase contract was concluded in Hong Kong, but the Hong Kong business as a member of a group, 'books' profits under instructions from its overseas principal and/or associates, then if the activities of the Hong Kong business were confined to issuing invoices based on terms already concluded by overseas associates, arranging letters of credit, operating a bank account and maintaining account records, any profits so 'booked' to the Hong Kong business were not taxable in Hong Kong. However paragraph 7(g) (or paragraph 9 of the 1998 edition) of DIPN 21 does not apply to the Appellant. It relates only to the sale and purchase of commodities, not services. The disputed incomes arose from services rendered as stock brokers and not directly from any trading of goods. Though not argued before us, it would have been difficult to persuade us that paragraph 7(g) of DIPN 21 applied to services.

94. The profits in dispute were the profits reported by the Appellant to the Revenue in its tax returns as revised by correspondence from its tax representatives. If the evidence showed mere booking and everything else was done outside Hong Kong, then profits did not arise in Hong Kong. If the evidence was that it was more than mere booking, then we must see what else had been done, whether that which was done earned the profits and where such acts were done.

95. Counsel for the Appellant suggested that the disputed incomes were 'booked' or 're-invoiced' profits. We were told by Mr J that, in most cases, a Group company, which is termed by the witnesses as the 'booking office', would book client trade back-to-back with the execution office and the client on a matched book basis. But this description is flawed. Why did the execution office's client trade booking have to be back-to-back with the booking office's client trade booking? Would not the important back-to-back booking be the bookings of client trades in the Group Contracting Party's books back-to-back with the booking office's books? The first 'booking' described in the immediately subsequent paragraph is an example of this more important back-to-back booking.

96. There were several situations in the evidence which referred to 'bookings':

(a) Client orders relating to trades in Country 5's securities were said to be booked either to the Appellant or to Company B. We do not know why or how the

differentiation between booking to the Appellant or to Company B was made. Nor do we know the ratio of such bookings between Company B and the Appellant. We were told that there were certain client trades relating to Country 1's clients which were booked to the Appellant. The reason was said to be to take advantage of Country 1's VAT legislation structure so that if the booking was made to the Hong Kong incorporated Appellant, presumably for some VAT advantage would accrue either to the client or to the Group. This contradicted the Appellant's assertion that the back-to-back booking was between the executing entity and the booking entity.

(b) The booking of all client trades on the City 11 stock exchange was said to be made to the Country 3's Group company to take advantage of reciprocal tax arrangements between Countries 3 and 9.

(c) Certain client orders generated by Asian sales desks were said to be booked to the Appellant while certain other client orders generated by European sales desks were said to be booked to another Group company. Prior to the Group establishing a Group company and obtaining a brokerage licence to trade on the Country 3 and City 12 exchanges, client orders relating to trades in Countries 3, 4 and 8 securities from client orders generated by sales offices in Asia were said to be booked to the Appellant, except for the period between October 1990 and October 1992 when such bookings were made to another Hong Kong company of the Group called Company B-Options. Client orders generated by the sales desk in Europe were booked to Company B (which operates out of City 1 but appears to be a company incorporated on Island T, a colony of Country 1). No mention was made as to how orders generated by sales desks in North America and other regions were booked. After the Group obtained a brokerage licence for the City 12 and Country 3 exchanges, the Country 4 Group company executing entity and the Country 3 Group company executing entity were said to maintain Hong Kong and City 1 ledgers for client trades in the City 12 and Country 3 markets. It is not clear what the consequence of 'maintaining separate ledgers' was. The evidence relating to the settlement of client trades suggested that the Country 3 Group company was acting as the agent or attorney under powers of attorney from the Appellant in the settlement process. Thus for client orders for securities traded on the Country 3, Cities 10 and 12 exchanges originating in sales desks in Asia (and we note, not just Hong Kong), it would seem that client trades were booked to the Appellant (except for the periods between 1990 and 1992 for the Country 3 and City 10 traded securities booked to Company B-Options.

(d) Client trades in respect of Country 11 securities were said to be booked to the Appellant prior to sometime in 1994 and subsequently to a Hong Kong company

called Company B-Overseas. The reason was said to be due to the Appellant and Company B-Overseas acting as the settlement agents in respect of client trades in Country 11 securities. Strictly speaking this was not mere booking.

97. In addition to this suggestion, two of the witnesses described to us the income or commission allocation policy of the Group which appeared to suggest 'bookings' or some form of internal allocation of income or transfer of money between Group companies.

Commission or income allocation policy and bookings

98. Mr E and Mr J described the allocation policy of the Group. The nature of this policy had been described as both an income allocation policy and a commission allocation policy. This allocation policy was used to support the use of the Appellant as a booking office. The policy as described to us was as follows:

(a) According to Mr J, the development of business out of Hong Kong and the convenience of the Appellant to the time zones of the Asian stock exchanges made it suitable to be used as a booking entity for Agency Brokerage in the Asian region. The Group developed certain practices with regard to the disbursement of Agency Brokerage commission income, which practices were reflected in agreements between Group companies. These practices had regard to such matters as where the orders originated, the location of the client liaison office, where the orders were executed and payment for the transactions or the delivery of shares to or from the stock exchange was due and where booking and settlement were performed. There was no particular strategy to where the matters ancillary to execution took place. They were undertaken by the Group office that was suitable and convenient to the business at the time and were thereafter changed to conform with the implementation of infrastructure and administrative systems by the Group worldwide.

(b) According to Mr E, the allocation of commission within the Group was determined having regard to the totality of the relevant considerations, namely the Group companies responsible for obtaining the order, the execution, settlement and the Group's overall fiscal strategies. Country-by-country amendments to the general allocation of commission arose by reason of such matters as reducing the commission margins, minimum and agreed commissions and regulatory constraints. Mr J stated that a number of matters determined the booking entity. These included regulatory considerations of a stock exchange, the development of the Group operations in a country, whether a Group company was a registered dealer and the extent to which foreign exchange or other regulatory restrictions affected settlement operations.

99. It can be seen that the policy as described by Mr E and Mr J was similar in that the allocation policy considered where the client order originated and where and how client orders were executed and settled. This suggested some sort of allocation of income at the point where the client was legally liable to pay the commission. But the policy as described by Mr E and Mr J was also different. Mr E's description of the allocation policy was wider than Mr J's description by including overall fiscal considerations and also by regulatory restraints on the manner that executing entities charged their Execution Commissions (paragraph 117(a) below refers) or rebate (as in Country 5) and other regulatory constraints on foreign traders and settlement (such as Country 6 or Country 10). The wider policy described by Mr E suggested a further element of internal distribution of income between Group companies (or allocation of costs and expenses, from another perspective) after the client was liable to pay the commission to a Group company for undertaking the client trade. The term 'booking' of income was used in both narrower and wider formulation of the allocation policy.

100. If the mere 'booking' of income to the Appellant was booking of commission paid by clients of the Group (solicited or belonging to Group companies other than the Appellant) to the Appellant, evidence was required to show that the Group had structured its documents with clients (who paid the commission or income) so that these clients were the clients of the booking entity, which was the Appellant. There was no evidence that this was so. If it could be argued that the booking entity need not be the contracting party receiving the income, then one must look at whether the booking entity has done the minimum amount of work of minimum added value to earn the income. For this we will be looking at the role played by the Appellant in the sales, execution and settlement of client trades of securities in the Asian markets.

101. If the mere 'booking' of income was the transfer of money between Group companies, 'commission or income allocation' was a misnomer. Any money transferred between Group companies pursuant to any allocation policy would not be classified as income received from clients. What would then be important would be whether there were commercial reasons for the transfers of money between Group companies. The evidence suggested some reasons. But it was not shown to us how much of the disputed income and how much of each of Commission Income and Marketing Income were 'allocated' in this manner to the Appellant. If all Commission Income and Marketing Income were thus allocated, there was no breakdown of how the income figures and the accounts of the Appellant related to the specific 'booking' situations set out in paragraph 96 above or any other 'booking' situations which we may have missed. Further, there could well be justifiable commercial reasons for transfers of money between Group companies to 'allocate' the costs or expense incurred by one Group company for the benefit of the whole Group or some companies in the Group. As we have noted in paragraphs 69 to 73 above, there was evidence of internal transfers between Group companies of research costs which were good commercial reasons beyond mere 'bookings' (and which was not included in the allocation policies described to us).

102. It was insufficient for the Appellant to describe a general income or commission allocation policy without establishing, on a balance of probabilities, how any of the income under dispute was a specific application of the allocation policy (whether it related to the narrow or wider formulation of the allocation policy). Even more so when the policy appeared to fluctuate and change with time and could be differently implemented depending the different countries and places involved. To establish mere bookings or re-invoicing, a taxpayer must establish that booking of the income was all that it did. For trading of commodities, paragraph 7(g) of DIPN 21 allowed some other activities such as invoicing, maintaining books and operating bank accounts. No examples were provided by DIPN 21 for re-invoicing for services provided but inherently, the same rationale of minimum involvement would operate. Thus insofar as the Appellant is submitting that any of the disputed incomes were in the nature of re-invoicing, it would be pertinent to look at what the Appellant had done or not done in the research, sale, execution and settlement of client trades in the Asian markets.

Role of the Appellant

103. In addition to the above doubts raised in respect of the bookings and the income or commission allocation policy, there was evidence that the Appellant played more than a mere 'booking' role. From the evidence, we are able to see that the Appellant undertook functions which exceeded that of the Appellant being merely a local office handling only Hong Kong clients or merely executing client trades as the executing entity in Hong Kong or merely booking client trades of securities listed in the Asian markets. It was more of a regional office of the Group in the Asian Pacific region. It was its home base for the Asian Pacific time zone. It received client orders originating from outside the Asian Pacific region in respect of securities traded in the Asian Pacific markets and passed them on to the relevant executing entities in the relevant markets (sometimes through another Group company in the region). It provided services to Hong Kong clients for trading of foreign securities. It housed the back office computer equipment (with the exception of Country 5 and perhaps Country 3). Sometimes the Appellant's involvement in respect of foreign securities was more intense, such as Country 11. And there were also situations where the Appellant's involvement may have been much less, such as Country 5.

104. Counsel for the Revenue had listed in detail references in the evidence which showed that the Appellant was not operating in a passive or mere 'booking' mode. We list out some of these references:

(a) Mr J mentioned that the Appellant procured both local and overseas investors to subscribe for securities and bond issues in which Bank B and Group companies were underwriting in the Asian Region in the generation of the Placements Income. For the other incomes, Mr J also described the activities undertaken by the Appellant within the Group. According to Mr J, these included providing research to clients for Hong Kong securities, receiving client orders from its own clients and clients of other Group companies in Asia, relaying verbal

confirmations of client trades from executing entities back to the sales desk, providing some transaction processing and back office settlement support for other regional exchanges, undertaking client trades on Country 6's securities through the Country 6's Group company in Cities 1, 3 and 13 and issuing settlement instructions and charging fees for funding entrustment deposit and foreign exchange transactions (being the only way in which a foreigner can indirectly trade Country 6's securities) in respect of Country 6's trades and, from an order flow perspective, servicing the Cities 8, 9 and Country 10 stock exchanges.

(b) Mr E testified that the Appellant had no Hong Kong based staff dedicated to the Country 5 equities market and orders would generally be placed by the client directly with the City 6 sales staff or through System H (but Mr F's assertion in this regard contradicted the testimony of Mr E who said that the originating sales desk places the order to Company B-Country 5.) However, for transactions booked to the Appellant, the Appellant inputted the client trades into the back office system for computer generation of contract notes. This would indicate that the Appellant was responsible for part of the back office operations. Mr E mentioned that the Appellant provided ancillary support in receiving computer files and arranging computer generated contract notes to be issued for some of the period under appeal.

(c) Mr F said that there was sales capability in Hong Kong for the Countries 3, 8 and 9 markets. For the Country 6 market, such capability existed in Hong Kong after 1992 in the form of one person called Mr N who handled Country 11 trades as well. (Mr F did not mention who employed such sales staff and whether they handled clients from Hong Kong only or clients from other countries as well irrespective of the countries of the equities traded). Mr F further mentioned that the Appellant sometimes supported or facilitated settlement process. The Appellant had settlement teams for the Countries 7 and 10 markets based in Hong Kong with the Appellant playing a similar role to coordinate settlement of Countries 4 and 11 securities. For the principal markets of Countries 3, 5 and 6, Mr F mentioned that the Appellant's role was limited to some back office settlement support or facilitation of trades booked from the Appellant.

105. We could appreciate the difficulty of the Revenue in attempting to obtain straight forward answers from the Appellant. The last major attempt to obtain answers was made by the Revenue in its letter dated 15 September 1994. In this letter, very pertinent questions relating to the set-up and personnel of the Appellant's offices were not answered. These questions asked for an organization chart showing the structure of the Appellant and its various departments; the number of personnel employed in all the departments, their job titles and duties. We are unable to see any reason why answers could not be provided to the Revenue or to this Board.

106. The organization set-up of the Appellant's offices and departments in Hong Kong was the subject of cross-examination by Counsel for the Revenue. She had pointed out that there appeared to be some allocation expenses according to a country-by-country breakdown of the securities traded by clients through the Appellant. This was found in an appendix D supplied by Accountants' Firm D to the Revenue dated 19 November 1991. Appendix D set out the calculation of the attributable overhead expenses which produced the income which the Appellant alleged was not taxable in Hong Kong due to the fact that the client orders were executed outside Hong Kong and related to non-Hong Kong securities. It can be clearly seen from this appendix D that the allocation of the overhead expenses is broken down by reference to various countries (Countries 3 and 8, Country 4, Country 5, Country 6, Country 9, Country 11 and Hong Kong). There were also non-country categories found in the allocation, these were 'Others', '[Country 6's] Bond', 'Futures' and 'Country Fund'. By and large, the breakdown or allocation was on a country-by-country basis. We now list out how the expenses were allocated to each country and the basis on which the allocation was made:

	Expense	**Basis of allocation**
(a)	Occupancy	by floor ratio
(b)	Communications	by dealer headcount
(c)	Staff welfare	by total headcount (except staff housing)
(d)	Travel and entertaining	on an actual basis
(e)	Information services	by sales and research headcount
(f)	EDP* and related costs (*Electronic Data Processing)	by total headcount
(g)	Reference and research	on an actual basis
(h)	Professional fees	on an actual basis
(i)	Management fee	no basis mentioned and allocated to only Country 11 and others
(j)	Others	by total headcount
(k)	Salaries	by total headcount
(l)	Year end bonuses	by total headcount
(m)	Central overhead allocation	by total headcount

107. From this breakdown of expenses to different countries, it could easily be seen that the Appellant was more than passively involved in markets other than the Hong Kong equity market. Mr E was cross-examined on appendix D, no reasonable answers could be extracted from him. He either did not know or could not recall or his answers were ambivalent.

108. Based on what the witnesses have described to us and the allocation of the expenses of the Appellant to other countries, there was considerable doubt cast on the Appellant's case that the Appellant was merely a booking office with no additional function.

Marketing Income and Introduction Commission Agreements

109. Despite the suggestion that the Commission Income and Marketing Income be treated in a similar manner, the difference between Commission and Marketing Incomes is underscored by the intra-group commission arrangement agreements produced and by internal Group communications in the bundle of documents regarding Countries 3, 8 and 9 under 'Introduction Commission Agreements and related documents'. These were the documents under which the Marketing Income was said to be received by the Appellant. There were two types of intra-group commission agreements in the evidence ('Intra-Group Commission Agreements').

First type – Country 6 securities commission agreement

(a) The first type of Intra-Group Commission Agreement was a service agreement dated 1 October 1987 made between the Appellant and Company B an Island T company said to be engaged in the Country 1 and European securities activities. This service agreement is referred to as the 'Company B Country 6's Securities Service Agreement 87'.

(b) In the Company B Country 6's Securities Service Agreement 87, the Appellant was described as being engaged in securities activities in Hong Kong and the South East Asian, Far Eastern and Australian markets. The Appellant was to provide support and assistance to Company B in marketing Country 6's securities to customers in Hong Kong, South East Asia, The Far East and Australasia with no responsibilities in execution, contracting and settlement. In return 50% of the total income derived from Country 6's securities activities would be paid to the Appellant. The service agreement would continue until terminated by 60 days' notice. Its governing law was Hong Kong law.

(c) Unlike the second type of commissions agreements (hereinafter mentioned), the Company B Country 6's Securities Service Agreement 87 was the only one of its kind produced and appeared to be peculiar to Country 6's securities only. This agreement was direct collaboration of the statements of fact in Company B's letter to the Revenue dated 25 November 1994 mentioned in paragraph 88(d) of this decision.

Second type – Introduction Commission Agreements

(d) We refer to such second type agreements as 'Introduction Commission Agreements'. The Introduction Commission Agreements could be further divided into two sub-types with those in which the Appellant was a contracting party (there were three such agreements) and those in which the Appellant was not (there were two such agreements). The first sub-type can be exemplified by

a commission agreement produced to the Revenue in the pre-Determination correspondence and to us. It was an agreement dated 1 October 1990 (which superseded a previous agreement dated one year earlier) made between the Appellant and Company B-Country 5 which remained in full force and effect unless terminated by either party on 30 days' notice. This agreement is referred to as the 'Company B-Country 5 Introduction Commission Agreement 90'.

(i) The purpose of this agreement was stated to be to 'determine the basis for calculating the commission receivable by one party in respect business introduced by it to the other'. Commission earned from clients was shared between an introducing party and a booking party at 50% of the net retained commissions for transactions on Countries 4, 5, 11 and Hong Kong equities. The booking party was to pay the introducing party. 'Net retained commission' was defined as the gross commission less brokerage or commission payable to third parties. The commission was payable net in Country 5's currency and the governing law of the agreement was Hong Kong law.

(ii) Although Company B-Country 5 Introduction Commission Agreement 90 itself did not specifically define 'introducing party' and 'booking party', in the context of the agreement, it was obvious that they meant the capacity under which the parties to the agreement were acting relevant to a given trade order of the client. Further taking the words in their ordinary meaning, 'introducing party' would be the party who introduced the business (the trade order) and the 'booking party' would be the party to whom the securities trade order would be booked from a book-keeping point of view.

(iii) The other Introduction Commission Agreements in which the Appellant was a contracting party were:

    (1) A commission agreement dated 1 October 1989 made between the Appellant and Company B-Country 3. Commission earned from clients on transactions in Countries 3, 8 and 9 equities were shared 50-50 between the booking and introducing parties. Commissions earned in Hong Kong equities transactions were shared by the booking party paying any commission in excess of 0.25%. This agreement is referred to as the 'Company B-Country 3 Introduction Commission Agreement 89'. The Company B-Country 3 Introduction Commission Agreement 89 is identical in wording with the Company B-Country 5 Introduction Commission Agreement 90 except for their dates, the parties and the different countries of the equities involved. By another Introduction Commission Agreement

dated 25 September 1990, the Company B-Country 3 Introduction Commission Agreement 89 was amended by the addition of payment of 50% of the net retained commission for transactions in Country 4's equities and backdated the payment of such commission to 1 October 1989.

(2) A commission agreement dated 22 October 1992 made between the Appellant and Company B-Country 3 ('the Company B-Country 3 Introduction Commission Agreement 92'). Commission was to be paid by the booking party to be the introducing party in similar wording as the Company B-Country 3 Introduction Commission Agreement 89 but with the following notable difference.

(a) Countries 3 and 8 equities had been left out.

(b) Country 4 equities had been added.

(c) An additional clause stating the 'the party of [the Appellant] is deemed to include the sales representatives of [the Appellant] who are domiciled throughout the world.'

According to Mr E, in October 1992 Company B-Country 3 was admitted into the Country 3 stock exchange, hence the amendment to the Company B-Country 3 Introduction Commission Agreement 89 by the Company B-Country 3 Introduction Commission Agreement 92 whereby commissions earned on Countries 3 and 8 equities were deleted due to the illegality of rebates for trades Company B-Country 3 executed in Country 3.

(iv) There were two Introduction Commission Agreements produced to us which did not involve the Appellant as contracting party:

(1) There was an agreement dated 1 October 1989 made between Company B-Country 12 and Company B-Country 3 with the similar wording as the Company B-Country 3 Introduction Commission Agreement 89 but this time identifying that payer and payee of the 50% share of the commission and it related to commissions earned for Country 9 equities only. Company B-Country 3 was to pay Company B-Country 12 50% of the net retained commission. Governing law was Country 12 law. Company B-Country 12 was a broker or dealer apparently within the Country 12 part of the Group.

(2) There was another agreement with similar wording for commissions in Country 9 equities between Company B-Country 3 and Company B-Country 13. Governing law was Country 3 law.

Comments on Intra-Group Commission Agreements

110. The basis for the Introduction Commission Agreements was for the booking party to share or pay the introducing party 50% of the net commission said to be received by the booking party. According to the working of the agreements, the booking party was not (though it could be) the executing entity. Logically, it would be obvious that the commission was a payment of money between Group companies, being some Group internal arrangement where the introducing Group company was paid a commission by the booking Group company. This introduction commission had nothing to do with the commission paid by clients for the Agency Brokerage service nor the commission paid to the executing entity. Further, the commission paid by clients would have been paid to the Group Contracting Party rather than the booking party. It would therefore be wrong and confusing to state that the booking party shared the commission paid by clients with the introducing party.

111. It was also wrong and confusing to mix the commission paid by clients with the introduction commission by presenting the introduction commission as sharing of the commission paid by clients as Mr E and Mr J have done in their testimony. This confusion could also be found in the rebate of commission for Country 9 securities originating from Hong Kong through a series of internal correspondence (which also shed light on the commissions arising from trades in Country 9 equities). The relevant correspondence is set out as follows:

(a) There was a fax dated 26 June 1990 from the Appellant to Company B-Country 3 confirming that the 'rebate' (as the sharing of the introduction commission was termed in this fax) to the Appellant regarding Country 9 commission income related solely to Hong Kong based clients. Company B-Country 3 confirmed this in an undated fax (but in the copy produced as evidence, marked with a receipt chop with the date of 28 June 1990). By the same fax, Company B-Country 3 asked for confirmation that 'rebates' relating to Countries 3 and 8 commission income were to continue to be accrued under Hong Kong for clients based both with the Appellant and the City 1 or European offices (which had been the practice for the year ended September 1989). This 'rebate' of commission on Hong Kong originated Country 9 trades was questioned in a fax from Company B to the Hong Kong office dated 27 November 1990.

(b) A telex response dated 28 November 1990 was given by the Hong Kong office as follows: 'Currently the [South East Asia] sales desk in [City 1] is perceived to be an extension of Hong Kong. When the [Country 3] office commenced business therefore it made sence [*sic*] that [Country 3] rebated Hong Kong for

[City 1] orders; it also made tax sense since we took income from a relatively high tax jurisdiction to a low one. This reasoning still stands. (new paragraph) The inconsistency arises because the [Country 9] income is taxed at lower rates than those applied in Hong Kong, and in an attempt to maintain rebate structures on all income streams while trying to benefit from the beneficial rates in [Country 3] we decided to base the rebate to Hong Kong purely on the Hong Kong generated income. It was recognized at the time that should the authorities review this arrangement in detail questions may be raised. However we argued at the time that by maintaining rebates on all income other than [City 1], we may be able to maintain the status quo, without encouraging enquiries from the authorities, and get some benefit from the tax rates in [Country 3].'

(c) The 'rebate' of commission for Hong Kong originated Country 9 equities trades was mentioned yet again in a fax dated 6 May 1991 discussing amendments to the then current Introduction Commission Agreement between Company B-Country 3 and the Appellant. In this fax, this question was said to be outstanding and that 'currently only [Country 9] business introduced by [the Appellant] gives rise to a rebate, and that introduced by [City 1] and [City 2] does not. Since we enjoy a concessionary 10% tax rate on [Country 9] income in [Country 3], this is tax effective but not consistent with the [Country 3]/[Country 8] rebates.' There were other correspondence on this subject matter.

By viewing the payments as rebates of commission there is confusion or mixing of the client commission paid by client (to presumably the Group Contracting Party or the booking office) with the introduction commission (payable under Company B-Country 3 Introduction Commission Agreement 89 or any other similar agreement, if such existed).

112. Other than the general assertion that Marketing Income resulted from Intra-Group Commission Agreements by Mr E, it was not evident from the evidence how specific parts of the Marketing Income (or Commission Income, if it were to be treated in the same manner as the Marketing Income) related to each of the Intra-Group Commission Agreements. There was no breakdown of how much income and when such income was generated from each Intra-Group Commission Agreement.

113. Other than the six Intra-Group Commission Agreements which we have set out above, no other similar agreements were produced to us. As these agreements were said to be the basis of the Marketing Income as suggested by the Appellant, they covered only the payment of introduction commission to the Appellant by Company B, Company B-Country 3 and Company B-Country 5 in respect of the introduction of client orders by the Appellant to Company B, Company B-Country 3 and Company B-Country 5 for equities listed in Countries 3, 4, 5, 6, 8 and 9 for the various periods of validity as set out in the Company B Country 6's Securities Service

Agreement 87, Company B-Country 5 Introduction Commission Agreement 90, Company B-Country 3 Introduction Commission Agreement 89 and Company B-Country 3 Introduction Commission Agreement 92. (The two Introduction Commission Agreements in which the Appellant was not a contracting party related to Country 9 securities but which were irrelevant to this appeal since the Appellant would not have received any income pursuant to these two agreements.) Looking at appendices B to B4 of the statement of agreed facts, it could be seen that most of the Marketing Income related to client trades of securities listed in the six countries covered by the Introduction Commission Agreements. This would be consistent with the assertion that the Introduction Commission Agreements served as the basis for the payment of the Marketing Income to the Appellant. However, there was Marketing Income of the Appellant reported for client trades in securities of countries not listed in the Introduction Commission Agreements (Country 10 1993/94, 1994/95 and Country 11 1994/95) and there was Marketing Income in negative figures (marketing expenses?) for Country 4's securities from 1990/91 to 1994/95, Country 11's securities from 1991/92 to 1993/94 and Country 7's securities for 1994/95. Further, it would be interesting to know the identity of the party paying the commissions to the Appellant, when such payments were made and whether such commissions related to the securities covered by the respective Intra-Group Commission Agreements. If the disputed incomes could be so broken down according to the Intra-Group Commission Agreements, it would have assisted the Appellant's case. Where there were any figures not covered by the Intra-Group Commission Agreements (such as booking under some income or commission allocation policy), a breakdown of these figures to each specific application of this policy would also have been helpful. But this would have contradicted the assertion by Mr E that the Intra-Group Commission Agreements were the documents that supported the Marketing Income of the Appellant.

114. That the Intra-Group Commission Agreements were part of some deliberate Group strategy was evident from the various chains of internal memos and faxes (between 2 March 1990 and 19 October 1992) between Group offices and especially between the City 1, Country 3 and Hong Kong offices. An internal memo from Mr U to persons at the Group offices in Cities 1, 6, 13, 14, Country 3 and Hong Kong dated 2 March 1990 suggested that there was deliberate rationalization of commission sharing within the Group. This internal memo confirmed the finalization of the various commission sharing agreements and requested the various offices to monitor any need to amend these agreements on an on-going basis and to notify City 1 of any proposed changes. Subsequent internal correspondence showed that Company B-Country 3 requested some changes which were rejected by the City 1 office. The wording of the agreements themselves gives us an idea of part of the strategy for arranging the commissions between the introducing party and the booking party but we are unable to tell from the correspondence the reason(s) or rationale behind the strategy.

115. It may be possible that the Marketing Income was not based solely on the Intra-Group Commission Agreements but this was not in the evidence. According to Mr E, the basis of the Marketing Income was the Intra-Group Commission Agreements. If the Marketing Income was based on more than the Intra-Group Commission Agreements and if it was based on the income or

commission allocation policy of the Group as described to us by Mr E and Mr J, there was no explanation of how or why the Marketing Income was allocated to the Appellant other than under a general application of this policy (as previously noted). An assertion by way of a general description of the allocation policy without further evidence and breakdown of the specific application of the policy is insufficient to discharge the Appellant's onus of proof.

Imprecision and confusion

116. Terminological exactitude and internal consistency in the consideration of the evidence and submissions made to us are vital in trying to understand the nature of the Appellant's income and its territorial source for Hong Kong tax purpose. This is especially so when we are dealing with a group with companies established for different purposes and situated in different countries, with its clientele from different countries and making securities transactions on behalf of the group's clients in different markets of different countries. Bearing in mind our advantage of hindsight, we make this observation as a note to emphasize the difficulty and confusion that arose in understanding and considering the evidence and the submissions to this Board. We have already referred to some of these confusions. A reiteration and further examples are as follows:

(a) We cannot understand the deliberate differentiation between Commission Income and Marketing Income in the accounts and tax returns and then the argument put to us that these two types of income were in fact the same.

(b) There was a mixture of the commission paid by or charged to clients with commission paid to the executing entity. In a simple scenario with a local client using a local stock broker to trade in local securities, these two types of commission would be the same. However in the Agency Brokerage business of the Group and in the context of the disputed incomes arising from trades of securities in countries foreign to the client by executing entities with whom the client had no contractual relationship or direct nexus, these two types of commission were very different in nature to each other. There were two different ways in which they were different. Firstly, they differ in who was paying whom. Secondly, the services to be performed were different. One was payment to arrange or procure the execution of a client trade in foreign securities which the service provider could not execute itself. The other was payment to execute the client trade in the market.

(c) Transfers of money between Group companies were thrown in the mixture of commission paid by clients with the commission paid to the executing entity as commission rebates or as sharing of commissions. The nature of transfer of money or payment between Group companies could not have been the same as either commission paid by clients or commission paid to the executing entity.

(d) There was the confusion in Mr E's evidence as to the incomes disputed under this appeal to which we have already referred. Clients paid their commission, but to whom were the commissions paid? Was it the commission paid by the client to the entity that the client treated as its stock broker? Was there a confusion between the commission which the client paid and the commission that was paid to the executing entity, despite Mr E being reminded that the commission charged by the executing entity was not relevant to this appeal? It is not possible to talk about client commission and then a rebate of commission by an executing entity as if they were the same income. They are different incomes with different natures.

(e) Wording such as sharing, rebating, disbursement and allocation of commission between Group companies were used. The Appellant appeared to imply that the disputed offshore income was amongst these categories of income. They were used as if they were the same type of income. In a way this was correct as they were all based initially on the commission income which a client had paid but from a tax and accounting point of view, such generalization would not do.

(f) 'Group sales desk' was often mentioned and we have taken this to mean the Group office in the same country or city where the client was from. Even the place of residence of the client was in contention since the clientele of the Group were institutional clients and funds, which span and spawn in different countries or different markets. Was the Group sales desk the same entity which a client regarded as its stock broker? Did the Group sales desk negotiate and sell to the client the Agency Brokerage services? Was it or was some other entity within the Group which was the contractual entity privy to the Agency Brokerage service contract with the client?

(g) When the Asian sales desk was mentioned, did it mean the Group sales desk physically situated in an Asian country or the Group sales desk situated in any country which deals exclusively in Asian securities? When Asian business or Asian Agency Brokerage business was mentioned, did it mean business relating to client orders from Asian clients or business from any client relating to Asian securities?

(h) The Appellant suggested that the disputed income was in the nature of 'bookings' of transactions to the Appellant for various reasons under an income or commission allocation policy. Was there a difference between the invoicing entity that billed the client and the contracting entity that contracted with client? Further was the booking entity the same as the invoicing entity? Were the Intra-Group Commission Agreements part of this allocation policy?

(i) There was also the confusion between Placements Income and Marketing Income for the Country 6's securities as noted in paragraph 85 of this decision.

(j) There were mentions of 'originating party' or 'introducing party' in the testimonies and documents. Was it the sales desk or the Group company who initiated the client order to the executing entity? We have assumed so from only a logical point of view and not from the evidence.

(k) Sometimes there were clear distinctions of client orders from different Group offices in Asia, Europe, Americas and other regions such as the segregation of booking of trades in Countries 3 and 8 equities between those originating from Asian regions and those from European regions. For the client trades of equities of other Asian markets (there being no evidence of client trades in equities of non-Asian markets), no such distinction was made.

(l) What happened to the client orders from non-Asian and non-European regions? No mention was made of such orders other than client orders directed to the Asian executing entities through the City 13 office. Or perhaps when reference was made to client trades in Asian securities, they included client orders originating from sales desks other than those located in Asia or Europe?

(m) According to Mr F, during the periods under appeal, approximately two-thirds of the Asian Agency Brokerage business was generated from sales effort in the Cities 1 and 13 offices. This was a mere estimate on his part based on the view that at that time the majority of the fund managers who were the Group's clients were from Countries 1 and 12 and that one of the main causes for the review of the workflow in his Report I was to deal with overnight fax orders (overnight for the Asian region meant orders from the Western hemisphere) which was causing problems. Even assuming that the Cities 1 and 13 offices were not the offices of the Appellant (and it was most likely that they were not), the two-thirds figure was meaningless without direct reference to the disputed incomes under appeal and without more global and detailed breakdowns of the commission earned by each company in the Group by client location, by the contract Agency Brokerage service provider in the Group, by the market in which client trades were executed or other meaningful information.

(n) We are told that Country 6's trades were routed through Company B for execution on the City 1 market. What could this statement possibly mean? Country 6's securities market was tightly regulated with foreign ownership restrictions and prohibition of settlement with foreign currency. Bank accounts in Cities 1 and 13 were used to deposit client's payment for Country 6's securities

trades. Certainly the City 1 market does not trade in Country 6's securities, or did it?

The functional categorization of the three types of income

117. From the point of view of the Group (ignoring the operations of the Agency Brokerage business through a myriad of global subsidiaries), there was only one source of income from the Agency Brokerage business and this was the commission received from clients. The other possible source would be profits earned from proprietary trading which are irrelevant in this appeal. The word 'commission' had been used rather loosely in this appeal with the result that income other than commissions payable by clients for the Agency Brokerage business was sometimes referred to as commissions or a share of commissions. Precise definition of the various types of income that we are able to ascertain from the evidence is required. There were three distinct types of income which could be attributed to the Appellant and which could arise from the relationships between (1) a Group company with another Group company, (2) a Group company and a client and (3) a Group company and a third party licensed broker:

(a) As the executing broker, a Group company or third party broker executing the trade on the relevant exchange was entitled to charge a brokerage commission. The rate of the commission charged and how much of this commission could be rebated were regulated, and regulated differently, by each market. For lack of a better word, we called this type of commission 'Execution Commission'. The Appellant would earn Execution Commission from execution of client trades of securities in the Hong Kong stock market.

(b) The Group Contracting Party would be the only entity within the Group legally entitled to charge its client commission at whatever was the agreed contract rate for the services rendered or arranged by the Group Contracting Party. We call this type of commission 'Client Commission'. The Appellant would earn Client Commission from its clients in which it was the Group Contracting Party.

(c) The Group would distribute amongst various Group companies various costs and expenses and also attempt to book profits or distribute profits amongst Group companies according to some allocation policy. We called this third type of commission 'Group Allocated Income'.

118. Despite the three functional categorizations above, one must bear in mind that there might be other categories if ALL the various different incomes which made up Commission Income and Marketing Income were set out in detail. As we have noted in paragraphs 12, 14 and 15 above, there was some income which had been ignored and there were individual elements within the total disputed income which did not seem to fit into any category of income mentioned by the Appellant in this appeal.

Group Allocated Income and its difference from Execution and Client Commission

119. It is the Appellant's case that this appeal did not concern Execution Commission. There were mentions of 'rebates' from the executing entity and from booking offices. There were mentions of 'sharing of the commission' received by the Group executing entity with other Group companies (and in the context of this appeal, rebated or shared with the Appellant). According to the Appellant's case, the offshore Group executing entity would earn a commission (presumably from the execution of a client trade but since only the word 'commission' was used, it was difficult to tell) or the offshore booking office would earn a commission (presumably under an Introduction Commission Agreement, again due to the generality of the word 'commission'). Part of this commission earned would then be 'rebated' or 'shared' wit h the Appellant. The Appellant would then treated this rebated or shared part of the commission as offshore income. The Appellant suggested that this shared or rebated income was part of the disputed income in this appeal whether Marketing Income or Commission Income.

120. We do not believe that 'rebate' or 'sharing' part of the commission or income earned by the executing entity or booking office was an accurate description of what had occurred. A client paid Client Commission to the Group Contracting Party. If the actual cash movement in respect of Client Commission was from the client to an entity other than the Group Contracting Party (most likely at the direction of the Group Contracting Party but we have no evidence of this), then this did not detract from the fact that legally the client was obligated to pay only to the Group Contracting Party. If the Group Contracting Party directed the client to pay another party, such payment would still be in satisfaction of the client's legal liability to pay the Group Contracting Party. When there was 'sharing' or 'rebating' of commission amongst Group companies, the payments (or receipts) were transfers of money between different legal entities within the same Group. This was Group Allocated Income and totally different in nature from Client Commission and Execution Commission. When the Appellant was said to have received any 'share' or 'rebate' of commission, the Appellant could only have received it as Group Allocated Income.

True relationship of various parties

121. From the evidence, we summarize generally the various transactions in a client trade and relationships between the various parties from which the Group earned its income.

(a) The Group was in the Agency Brokerage business of undertaking to arrange the purchase and sale of securities traded in any major global market. The Group was known for its excellent research in the Asian markets. The Group attracted institutional clients throughout the world through its reputation for research and possibly through other means.

(b) The client would have to contract with the Group Contracting Party and pay Client Commission in consideration of the Group Contracting Party providing the Agency Brokerage services. The Group Contracting Party was not acting as agent for any other Group company when it entered into the Agency Brokerage services contract with the client. In other words, the Group Contracting Party was not an agent of the executing entity or booking office. The relationship between the client and Group Contracting Party in the Agency Brokerage contract was a relationship between principal and principal. It is not known to us whether the client would usually be contracting with the Group company which was situated in the same residence or jurisdiction or region of the client. Perhaps there may not have been any prior contract between the client and the Group contracting company prior to the first order placed by the client. Perhaps the first order was the contract and the defining moment when the Agency Brokerage contractual obligations arose.

(c) The client then placed with the Group Contracting Party instructions to arrange execution of a client trade. A client trade could be a trade in securities in which the Group Contracting Party was able to deal directly in the market or it could be a trade in securities in a jurisdiction or market in which the Group Contracting Party could not deal directly (if the securities to be traded were of a type which could be traded by the Group Contracting Party as a licensed dealer, presumably, the contracting party would also be the executing entity and execute the client order but we have no evidence of this). Where the securities to be traded were securities which the Group Contracting Party could not, on its own, execute, the Group Contracting Party would arrange with another Group company to execute the client trade. The executing entity may not even have to be a Group company. It was a third party dealer if the Group did not have a presence in the market in which the securities ordered by the client were traded. Sometimes the client would even directly contact the executing entity to place the client order. When the Group Contracting Party 'passed on' the client order to the executing entity, the Group Contracting Party was actually placing an order, as principal and not as agent of the client, to the executing entity. Where the client had directly placed the client order with the executing entity, it could still be considered that the Group Contracting Party was the principal placing the client order with the executing entity. This is because it was still the Group Contracting Party which was contractually obligated to the client to arrange execution of the client order. When the client placed the client order directly with the executing entity, the order was placed by the client on behalf of the Group Contracting Party. The relationship between the Group Contracting Party and the executing entity in executing the client order was a relationship between principal and principal. The executing entity would be entitled to and did charge Execution

Commission. The Group Contracting Party would be liable to pay Execution Commission as part of its expenses to earn Client Commission.

(d) When the client order was executed, the executing entity would attend to settlement of the client trade. As far as the executing entity was concerned, it settled client trades according to the instructions of the Group Contracting Party which instructions would invariably be identical to the settlement instructions given by the client to the Group Contracting Party.

(e) The Group was operating in multi-jurisdictions under various companies with clients in different countries and was handling client orders for trades in securities in various local and foreign markets. It had three main divisions which generated the main income of its Agency Brokerage business, viz Client Commissions. The functions of each of the three main divisions were spread out to different companies in different jurisdictions. Yet these divisions so spread out were inter-connected with each other due to the international nature of the Agency Brokerage business. There was internal 'allocation' or spreading of certain costs and expenses amongst the Group companies. There were also attempts to 'book' profits to different companies for tax reasons. Incomes so received by a Group company from another Group company were Group Allocated Incomes. We were unable to see any systematic application of the income allocation policy described to us by the witnesses. Instead the payment and receipt of Group Allocated Incomes appeared to us to be more of an *ad hoc* and piecemeal distribution of costs and expenses and halfhearted attempts to 'book' certain incomes.

Sources of profits of each functional categorization of income

122. With the correct and proper categorization of the Appellant's income and based on the evidence that we have seen, we would make the following observations on what we might consider as relevant factors in the determination of the territorial source of three functional categories of incomes.

(a) Client Commission from client trades of foreign securities – It would appear that given the emphasis of the Appellant on Research and Sales and the fact that Execution could be carried out by a third party subcontractor (and hence a Group company executing a client trade would be a subcontractor or agent of the Group Contracting Party), the more important division which enabled the Group to earn Client Commissions was Research and Sales. There being evidence that there was already a distribution of the cost of Research amongst Group companies to enable a particular Group company in one country to obtain clients to trade in securities of foreign markets, the remaining important factor in earning Client

Commission would be Sales. Following on this logic, any Client Commission earned by the Appellant from clients of the Appellant (in which the Appellant was the Group Contracting Party) would primarily be earned by Sales, all other factors being equal. Thus any Client Commission earned by the Appellant from the Appellant's clients in respect of client trades (irrespective of place of execution and settlement) would in all probability be sourced in Hong Kong fulfilling the three criteria of section 14 of the IRO. There may be other considerations which were not in the evidence but which could be relevant or crucial in determining the source of any Client Commission which we have not seen. For example, the place of negotiations, signing, governing law and jurisdiction of the Agency Brokerage contract may be important factors. A further example would be if the costs and expenses of the Settlements and/or Execution division of a foreign Group company responsible for settling the client trade constituted the majority of the expenses in a client trade and assuming that there were sufficient facts to conclude that this foreign Group company was acting as agent of the Appellant, then perhaps Execution and/or Settlements was more crucial than Research and Sales as acts which earned Client Commission. But these examples are unsupported by the evidence. We note here that clients of the Appellant in this sense would include any client whether resident in or outside Hong Kong.

(b) Execution Commission – Any Execution Commission earned by the Appellant (this being entirely unrelated to Client Commission paid to the Group Contracting Party) when it received client trades from foreign Group offices (or clients of foreign Group Contracting Parties) to execute client trades of Hong Kong securities in Hong Kong would be sourced in Hong Kong. In its capacity as the executing entity, the Appellant was in the similar position to a subcontracted third party executing entity. It received instructions from the foreign Group Contracting Party to execute the client trade and insofar as the Appellant was concerned the foreign Group Contracting Party was its principal and the foreign Group Contracting Party was the entity against whom the Appellant could enforce any non-payment of Execution Commission. More evidence on the relationship between the sales desk or Group Contracting Party on the one hand and the Appellant as executing entity on the other hand would have been helpful to determine the territorial source of Execution Commission. It appears that the crux of the Execution transaction being the dealing of the securities in the relevant exchange, the territorial source of Execution Commission would be the place of execution. If this were adequately supported by evidence, this would mean that any Execution Commission earned by the Appellant for execution of client trades in the Hong Kong market would be sourced in Hong Kong and subject to Hong Kong tax and any Execution Commission earned by any Group company (authorized to trade in a foreign exchange) for the execution of client trades in

foreign markets would not be sourced in Hong Kong.

(c) Group Allocated Income – As for any Group Allocated Income, we would need to look at each allocation or each type of allocation of Group Allocated Income to determine if each was a mere 'bookings' in the nature of re-invoicing or each was a commercially justifiable allocation of costs and expenses which went beyond mere book transfers, such as the research fees or management fees for assisting in Sales, Execution or Settlement. The evidence before us was insufficient for us to conclude that all the different types of allocation mentioned in the income or commission allocation policy of the Group were actually applied by the Appellant. Further, the Appellant had failed to correlate the application of the different types of allocation of income or commission applicable with the figures under dispute. The Appellant had not shown any breakdown of Group Allocated Income according to its various different types of allocation. Where there was evidence of bookings or transfers, the evidence was scant and incomplete.

123. It may be that the disputed incomes fitted into the Client Commission category or, as submitted by the Appellant, into the Group Allocated Income category. The suggested similar treatment of Commission Income and the Marketing Income did not assist. Further if the disputed income is Group Allocated Income, the criterion used to classify any Group Allocated Income as offshore (based on the place of execution of client trades; viz place where the securities were listed) was the wrong criterion to use.

Conclusions

124. We reject the argument that the correct criterion for determination of the disputed incomes as offshore as being the place where the securities of client trades were executed. This is not supported by the Appellant 's contention as to the importance of both research and sales. The place of execution was an important factor but only one of several in this respect. An illustration of this is to be found in the diversity of the entities executing the trades. Such entity need not be a Group company; it could, for example, be a third party broker with the necessary license for the relevant exchange.

125. For several reasons we conclude that the Appellant has not discharged its burden of proof to show that the Revenue's assessments were incorrect and/or excessive. These reasons are as follows:

(a) the inability to clearly categorize the different types of income and the aggregation of Marketing Income and Commission Income in the evidence and submissions of the Appellant;

(b) the imprecision of the evidence and its generality;

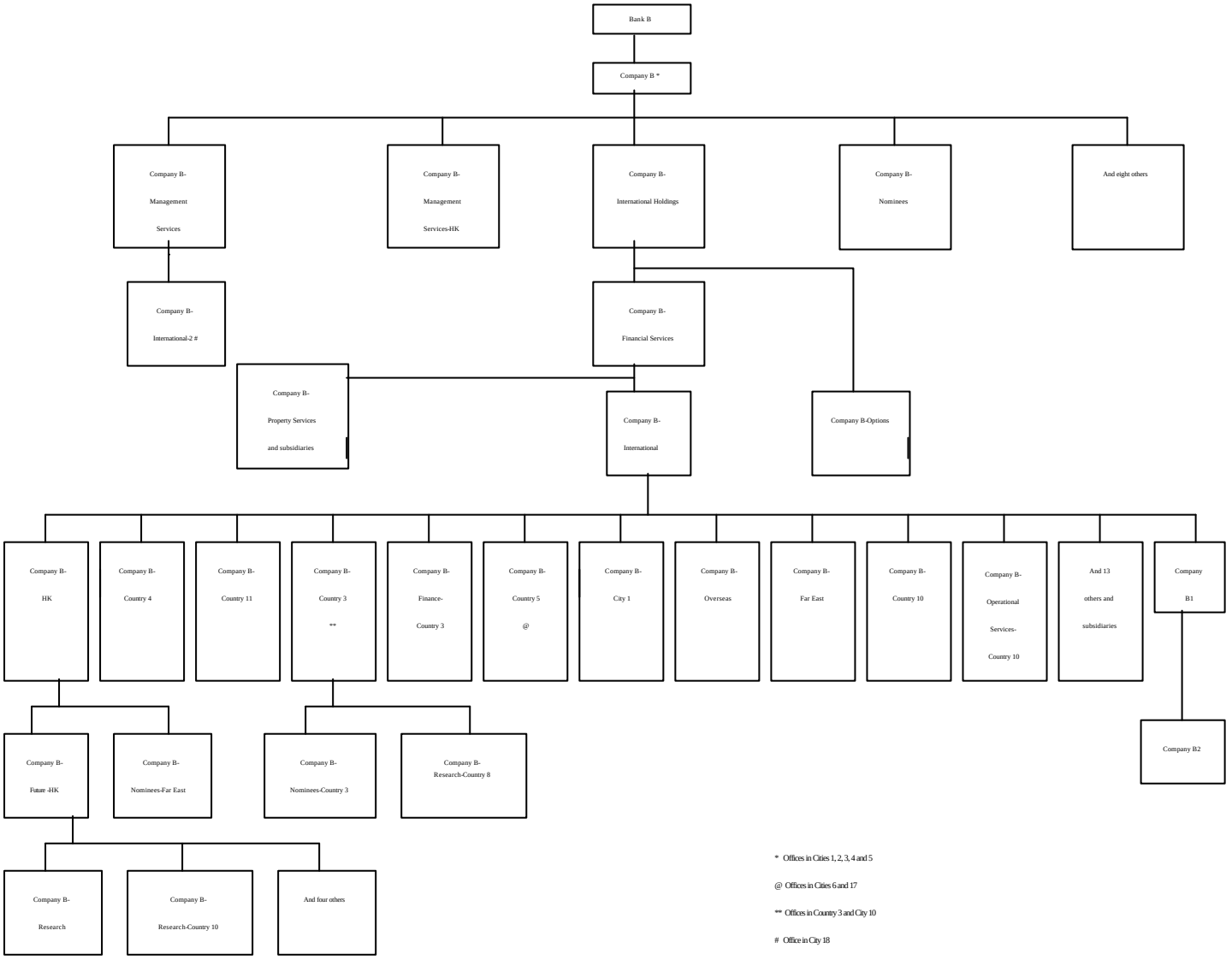
(c) the inability of the Appellant to relate the evidence adduced in the hearing (1) to the accounts of the Appellant and, more importantly, (2) to the various figures in the disputed incomes.

126. We agree with the submissions made by Counsel for the Revenue that the Appellant did not clearly establish a sufficient relationship between the general evidence, which it submitted, and the transactions which gave rise to the disputed income to prove that the assessments were incorrect and/or excessive. To establish this relationship, clear and detailed breakdowns of the disputed income into their individual categories with each category clearly supported by specific evidence would have been required. It would not be necessary to produce the written documentations relating to each and every transaction within each category. However, sample documentation for each category which related clearly with each category of income would have sufficed.

127. We have a general idea from the evidence of the factors needed to determine in this case. Generality in this respect is insufficient to enable us to determine with certainty what are and are not the important acts and omissions of the Appellant which give rise to the profits in question. We are unable to conclude which are the more important things done or not done by the Appellant to earn the disputed profits.

128. We have considered remitting this case back to the Revenue to continue the investigations with a re-categorization of disputed income. But we do not think that this is the proper approach. The Appellant's own accounts, tax returns and pre-Determination correspondence clearly indicated that there were differences between Commission Income and Marketing Income. The Appellant had the opportunity to revise the income figures with its major revision of these figures for the first three tax years under appeal. The Appellant had the opportunity to interpret these figures at the hearing of this Board. The Appellant had already been given the opportunity both in the pre-Determination stage and at this hearing to provide answers and evidence to the important questions relating to the organization set-up of the Appellant in Hong Kong and the interactions between clients and the Appellant (or a Group Contracting Party). It had either by choice or accident chosen not to provide the requested information. We therefore think that it would be inappropriate for the case to be remitted back to the Commissioner. At the end of the day, the Appellant has simply failed to discharge its burden of proof and for this reason, we would dismiss this appeal. We wish to thank Counsel for their able assistance in this appeal.

Group Chart of the Group



* Offices in Cities 1, 2, 3, 4 and 5

@ Offices in Cities 6 and 17

** Offices in Country 3 and City 10

Office in City 18

Summary and Comments on Evidence on Workflow and Sample Trade Documents (Country 4, Country 5)

	Country 4	Country 5
The Group licensed to trade on exchange floor?	According to Accountants' Firm D, local brokers were used, mostly Company V. Mr E said from January 1991, Company B-Country 4 executed on the City 12 exchange. Mr J said Company B-Country 4 was licensed as a stock broker and became a member of the exchange in August 1990.	Since 1986, Company B-Country 5 admitted to City 6 exchange.
Notes / Comments	Oral testimony provided by Mr E and Mr J. Company B-Country 4 was 80% owned by the Group and 20% by local partner. There was the Company B-Country 3 Introduction Commission Agreement 92 which stated that the booking party was to pay the introducing party 50% of commissions earned on Country 4 trades, Mr E said that Company B-Country 4 charged 0.5% execution commission and that the commission earned on trades booked to the Appellant was the amount that exceeded Company B-Country 4's 0.5%. Did the Appellant then have to share this part of the commission with Company B-Country 3?	Oral testimony and references to sample documents provided by Mr E. Each sample document does not necessarily relate to the same trade transactions except the 1991 trades in Company W.
Passing on of client orders	Group sales desk directs or places orders by fax, phone or telex to Company B-Country 4. Report I mentioned that clients also directly telephoned in their orders. Two sample telex orders in 1994 to Company B-Country 12-City 12 (Notes: No such company in City 12. Why was addressee not Company B-Country 4?) from Company B-Country 12 in City 13. Proprietary orders were given to City 12 (Report I).	Group sales desk directs or places orders by fax, phone or telex to Company B-Country 5. No sample trade orders were produced.
Trade in stock exchange or relevant market	Company B-Country 4 executed trade in the exchange.	Company B-Country 5 executed trade in the exchange.

	Country 4	Country 5
Dealing ticket	Three sample dealing tickets were produced. One for 1990 was the letterhead of the Appellant used to input into the Hong Kong settlement system. The other two for 1993 and 1995 were under Company B-Country 4 letterhead used to input into the Country 4 system.	One documentation of the Appellant titled 'Sold Dealing Ticket' was produced as sample.
Trade confirmation	Verbal confirmations were related back by Company B-Country 4 to the Group sales desk. According to Mr J, from 1991 to the second half of 1993, the Appellant recorded the trades and sent trade confirmations to client and settlement instructions to Company B-Country 4. After the second half of 1993, trade confirmations were sent directly by Company B-Country 4 to client (but this is contradicted by Report I and one of the sample telex confirmations for a 1995 trade which showed that the Appellant issued the telex confirmation in 1994 and 1995). Two telex confirmations from the Appellant to clients in 1990 and 1995 were produced stating that the Appellant was confirming execution of the trades.	A hard copy titled 'Trade Confirmation' was printed out by Company B-Country 5 (two samples for 1991 supplied). Verbal confirmations were related back by Company B-Country 5 to the Group sales desk. Sample Company B-Country 5 to the Appellant order or execution forms for two trading days in 1991 and 1993 were produced. Four sample order confirmation telexes were produced for trades in 1991, 1993 and 1994. Two samples did not show who were the senders and addressees and showed multiple trades in various equities. One sample was from Company B-Country 5 to the Appellant shoeing multiple trades in various equities. Last sample was from 'Company B-City 1' to a half legible addressee '?YDS BK' confirming one trade.
Contract note	One sample contract note was produced for a 1993 trade. It was issued by Company B-Country 4 to the Appellant. It is not known whether in this sample, the Appellant was the client requesting the trade or the contract note was issued in respect of trade ordered by a client and for some reason the Appellant was the addressee of the contract note.	Five sample contract notes for trades in 1990, 1991 and 1994 were produced. They were issued by the Appellant issued to clients and they stated that the Appellant had as brokers or as agent on client's behalf executed a trade.
Delivery advice		No samples were produced.
Custodian and clearing services	Company B-Country 4 providing securities clearing and custodian services to the Appellant in Country 4 by an agreement dated 4 April 1994.	Company B-Country 5 providing securities custodian services to the Appellant in September 1997.

	Country 4	Country 5
Other sample documents	Company B-Country 4 order or execution control sheets for three trade days in 1992 and 1993. Three daily settlement reports for three trade dates in 1990 and 1991 (two from Bank Y re-delivery of shares). One share delivery advice in 1993 issued by Company B-Country 4 with no addressee apparent.	
Booking	According to Mr J, after Company B-Country 4 established in 1990 until April 1994, all Country 4 equities trades were booked to the Appellant. According to Mr E and Mr J, from April 1994, Company B-Country 4 adopted similar operation method as Company B-Country 3 in that City 1 and Hong Kong books for Company B and the Appellant were kept by Company B-Country 4. The Appellant was used to book orders placed by Hong Kong or Asian clients.	Orders were booked to Company B or the Appellant. Some Hong Kong clients' orders were booked through the Appellant to obtain favourable VAT position. How much or approximate percentage of this type of booking was not in evidence.
How client paid commission and how this commission was shared	Mr J said that between 1991 and the second half of 1993, client paid commission to the Appellant's account in City 12 operated by Company B under P/A (Note: the P/A produced were dated in 1998) and the commission in the accounts of the Appellant in City 12 was distributed on the basis that Company B charged a fixed execution commission and the net commission that was received in excess of that was retained in the Appellant's account. For the period after the second half of 1993, only Hong Kong and Asian clients commissions were booked to the Appellant and these commissions were distributed between Company B and the Appellant in the same way.	Mr E said that client paid commission to the Appellant's account in City 6 operated by Company B-Country 5 under P/A. Company B-Country 5 charged a minimum commission of which 30% (for non-broker client) to 40% (for brokers and financial institutions) could be rebated. But the evidence does not mention how this is rebated if the client paid the commission to the Appellant's account. Further there were grouping advantages due to Company B-Country 5's commission rate being lower for higher volumes. Company B-Country 5 undertook the groupings but which would be 'communicated to Hong Kong where booking reasons necessitate it'. What did this mean? A further query arises. According to Mr E, market conditions for Country 5's securities meant that the scale commission charged by Company B-Country 5 could not be passed on in full to clients. The Appellant suffered a book loss. Not clear if book loss meant the Appellant paid the scale commission to Company B-Country 5 and received from client a commission which was less than the one paid to Company B-Country 5. But if the Appellant suffered book losses, why was there an income rather than loss reported? Further the pre-Determination correspondence made no mention of losses.

	Country 4	Country 5
Trade settlements and payments for and deliveries of securities	From 1991 to the second half of 1993, the Appellant recorded the trades and sent trade confirmation to client and settlement instructions to Company B-Country 4. After the second half of 1993, Company B-Country 4 sent trade confirmations to client and generated contract notes which were dispatched by the Appellant. Company B-Country 4 undertook delivery. Mr F said that the Appellant was used to coordinate settlement.	According to Mr E, this was performed by Company B-Country 5 settlement team in City 6.

Summary and Comments on Evidence on Workflow and Sample Trade Documents (Country 11, Country 3/Country 8)

	Country 11	Country 3/Country 8
The Group licensed to trade on exchange floor?	Since late 1990, Company B-Country 11 admitted to City 7 exchange.	For the City 10 exchange, always used local broker. For Country 3 exchange (where Countries 3 and 8 shares were traded), used local brokers until October 1992, when Company B-Country 3 was licensed to trade.
Notes / Comments	Oral testimony and references to sample documents provided by Mr E. There were two exchanges: Cities 7 and 15. All stock listed on both and freely transferable. Another Group company was involved in the process. This company was Company B-Overseas, a Hong Kong company. Mr E said that this company was used because of the relative insignificance of the City 7 market and the solvency ratio requirements of the Appellant. Proprietary orders from City 1 office treated as client orders.	Oral testimony and references to sample documents provided by Mr E. There were two relevant exchanges: Country 3 and City 10. For the Country 3 exchange, Company B-Country 3 acquired trade execution capability in October 1992. The Country 3 exchange traded Country 8 shares. Orders for Country 8 securities not listed in Country 3 were executed through third party brokers in City 10 exchange. There were proprietary orders.
Passing on of client orders	Group sales desk directs orders by phone, fax or telex to Company B-Country 11. There were telephone orders directly from domestic clients and some institutional overseas clients (Report I). One sample telex was provided for Country 11 orders in 1994 which was issued by Company B-City 1 to four addressees: the Appellant, Company B-Country 3, Company X and Company B-City 12.	Group sales desk directs or places orders by fax, phone or telex to Company B-Country 3. There were telephone orders from client directly (Report I). One sample telex was supplied for Country 3 securities. The transactions in this sample do not relate to the transactions in subsequent samples.
Trade in stock exchange or relevant market	Company B-Country 11 executed trade in the City 7 exchange. Orders not executed in the City 7 exchange may be executed in the City 15 exchange through a third party broker.	Prior to Company B-Country 3 obtaining its brokerage licence for the Country 3 exchange, the order would be executed through a local third party broker. After October 1992, Company B-Country 3 executed the trade in the Country 3 exchange. No direct mention of how trades in the City 10 exchange was executed. Presumably it must have been through third party local brokers.

	Country 11	Country 3/Country 8
Dealing ticket	No sample documentation produced.	Company B-Country 3's document titled 'Input Form (Deals)'. After 1992, another form titled 'Married Slip' appeared. One sample dealing ticket for each year under appeal (two for 1992) were supplied for Countries 3 and 8 securities.
Trade confirmation	Verbal confirmations were related back by Company B-Country 11 to the Group sales desk. Relevant sales desk onward verbally confirmed to client (Mr E). Executed trades of overseas clients were reported to Hong Kong office (Report I). One sample telex confirmation for 1994 was produced. It was issued by Company B-Overseas to client in which Company B-Overseas confirmed a sale order of client.	14 telex confirmations for each year and each Country 3 and Country 8 securities were produced. The telexes prior to October 1992 stated that the sender of the telex was Company B-Country 3 on behalf of the Appellant or Company B-Options. They were sent to either a Group company for the account of a client or to the client direct for the account of sub-account of the client. After October 1992, the sender of the telex was the Appellant directly instead of Company B-Country 3 on behalf of the Appellant and the addressee of the telex were clients directly.
Contract note	One sample contract note was produced. It was issued by Company B-Overseas addressed to client. It stated the Company B-Overseas as settlement agent for Company B-Country 11 confirmed execution of a sale order.	Eight sample contract notes (four for Country 3 and four for Country 8 securities) were supplied. They were for trades in 1990, 1991, pre-October 1992 and 1995. None for post October 1992, 1993 and 1994 trades were produced. Company B-Country 3 issued the 1990, 1991 and 1992 contract notes while the Appellant issued the 1995 contract notes. All stated that Company B-Country 3 or the Appellant, as the case may be, as agent has executed a trade order. The contract notes issued by Company B-Country 3 were issued to the Appellant or Company B-Options (Was the recipient of the contract note considered as originating Group company or sales desk or mere counter party in a booking exercise?) The two contract notes for 1995 were issued by the Appellant to the client direct.
Delivery advice	No samples were produced.	
Custodian and clearing services		Company B-Country 3 providing securities clearing and custodian services in Country 3 to (1) the Appellant by an agreement dated 13 October 1992, (2) Company B in City 1 by an agreement dated 22 October 1992 and (3) Company B-Country 12 in City 13 by an agreement dated 31 August 1995.
Other sample documents		Issued by Company B-Country 3 to blank out addressee enclosing cheques for sale orders or shares for purchase orders.

	Country 11	Country 3/Country 8
Booking	According to Mr E, prior to April 1994, trades were booked as the Appellant trades. 9 to 12 months thereafter, trades were booked to Company B-Overseas. Were such bookings confined to trade orders from Asian regions?	Orders from Asian regions booked in the Appellant during 1987 to October 1990, in Company B-Options during October 1990 to October 1992 and in the Appellant again during October 1992 to October 1995 (Mr E). According to Mr J, prior to October 1992, orders generated by European sales desk was booked under Company B and those generated by sales offices in Asia were booked under the Appellant. And after October 1992, Company B-Country 3 maintained Hong Kong and City 1 ledgers to book these trades.
How client paid commission and how this commission was shared	Mr E said that client paid commission to the Appellant's account in City 7 operated by Company B-Country 11 under P/A and that Company B-Country 11 and the Appellant received the commission from the brokerage charges paid by client. How Company B-Country 11 and the Appellant shared this commission is not evident to us.	Mr E said that for pre-October 1992, client originating from the Appellant paid to Company B-Country 3 account in Country 3. 50% net retained and balance paid to the Appellant account in Country 3 or Country 8 operated under P/A by Company B-Country 3. It was not clear how commission payments from client originating from other than the Appellant was treated. A different treatment is suggested through due to the using Company B as the booking party. Mr E said for post-October 1992, client paid commission to the Appellant's bank account operated by Company B-Country 3 under P/A in Country 3 or Country 8. Company B-Country 3 deducted its minimum commission for Country 3 trades and the local City 10 brokerage fee for Country 8 trades. And the Appellant was said to have retained the balance of the commission. But it was mentioned also in evidence that since October 1990, Countries 3 and 8 were deleted from the relevant commission sharing agreement because rebates were not permitted for Country 3. So was Company B-Country 3 first paid the commission and the balance paid to the Appellant's account maintained in Country 3 or did Company B-Country 3 withdraw its commission from the Appellant's bank account in Country 3? Confusing.
Trade settlements and payments for and deliveries of securities	According to Mr E, the Appellant and Company B-Overseas acted as settlement agents for Company B-Country 11. But he did not say where this was performed. Payments for and deliveries of securities were performed by Company B-Country 11. Mr F said that the Appellant was used to coordinate settlement.	According to Mr E, this took place in Country 3 and was undertaken by Company B-Country 3. There were no dedicated staff to manage Country 3 or Country 8 settlements. But there were ancillary support in receiving computer files and arranging for computer generated contract notes for some of the period under appeal.

Summary and Comments on Evidence on Workflow and Sample Trade Documents
(Country 6, Country 7)

	Country 6	Country 7
The Group licensed to trade on exchange floor?	Not clear from the evidence whether the Group obtained a licence in the City 3 exchange. A branch office in City 3 of Company B-International-City 3 commenced business in City 3 in October 1991. Company B-International was one of the intermediary holding companies in the Group. Company B-International-City 3 was mentioned to be an authorized broker who took custody of foreign buyer's identity card. But Mr F said they had to go through a local dealer.	No licence for the City 8 exchange. Special trading rights on City 9 exchange.
Notes / Comments	Oral testimony and references to sample documents provided by Mr J. According to Mr J, the Country 6's market was especially difficult for foreign investors. The Group operated very differently in this market due to foreign ownership restrictions on Country 6's securities and prohibition to settle trades from foreign currency accounts. The Group provided a funding mechanism through bank accounts in Cities 1 and 13 into which client payments for Country 6's securities were made and the lodgment of an 'entrustment deposit' (representing 40% of the trade order value) before an order to trade Country 6s securities was accepted. Trades had to be in client name or in the Group entity for which the foreign client's identity card registration had been obtained. From January 1992, the market was opened to foreigners to enable restricted purchase of Country 6's equities. From September 1992, entrustment deposits were abandoned. The operational structure for Country 6's securities is the odd man out and differs so substantially as to merit separate consideration from the other countries.	No sample documents were produced. Only Report I made references to Country 7. Country 7 meant the Cities 7 and 8 exchanges. There was proprietary trading from City 1 which was trade like client orders.

	Country 6	Country 7
Passing on of client orders	For trades after January 1992, Group sales desk directed orders by telex, fax or phone to Company B-International-City 3. Two sample documents in the form of handwritten overnight orders from City 1 to City 3 were produced. One telex order from Company B-City 16 to Company B-City 3. Country 6 had its own proprietary book and City 1 also had proprietary orders which were treated as client orders.	Orders received in Hong Kong from various Group sales desks.
Trade in stock exchange or relevant market	Not entirely clear who executed the trade. Most likely Company B-International-City 3 placing the order in the Country 6s computerized trading system utilizing client's prior registered swipe card.	City 8 broker executes trade in the City 8 exchange. Group trader executes trade in the City 9 exchange.
Dealing ticket	No dealing ticket title documents were produced. But sample documents titled 'execution reports' for daily trades in 3 January 1991, 3 January 1992 and 29 January 1992 and one set titled 'daily bargain list' for 15 October 1994 were produced.	Dealer completed the trading tickets. Though not mentioned directly, it appears that the dealer was a Group staff in Hong Kong as according to Mr F, the settlements team was in Hong Kong.
Trade confirmation	Verbal confirmations relayed back to Group sales desk which confirmed it with client. Two sample trade confirmations for 1993 trades by telex were produced. They were issued by the Appellant to client directly. The wording was slightly but materially different from the telex confirmations relating to trades of other countries' securities. The Appellant stated that 'as your agent, we confirm that [Company B-City 3] have bought for the client'.	Dealer received fax confirmations from the trade floors. There is no mention of how confirmation was given to client other than that they were sent by the settlements department.
Contract note	No sample contract notes were produced.	Not mentioned.
Delivery advice	No samples were produced.	Not mentioned.
Custodian and clearing services		
Other sample documents		
Booking	How trades in Country 6's securities were booked was not described to us.	Not mentioned. Probably booked by the Appellant as it is part of the disputed income.

	Country 6	Country 7
How client paid commission and how this commission was shared	Mr J said that prior to 1992, Country 6's income were placements and IPO fees and under the Company B Service Agreement 89, Company B paid 50% of the Country 6's income to the Appellant. After 1992, the Appellant issued instructions to client asking them to pay. But we are not sure to whom the commission was paid. From what Mr J said, it must have been someone's accounts in City 1 or City 13 in the special funding mechanism for Country 6's equities. According to Mr J, the funds representing the brokerage fee was converted to Country 6's currency and remitted to client's designated foreign exchange banks in City 3 who in turn credited to Company B-International-City 3's account. The Appellant charged a commission for funding the entrustment deposit and the foreign exchange transaction. This commission remained in its City 1 or City 13 accounts (depending on the currency of settlement chosen by the client). According to Mr J, the Appellant acted as the foreign exchange facilitator. We do not know whether the brokerage fee and/or the commission mentioned by Mr J had anything to do with Marketing Income or Commission Income under appeal. If they were related, how were they related?	Not mentioned.
Trade settlements and payments for and deliveries of securities	According to Mr J, this was performed by Company B-International-City 3 settlement team in City 3.	According to Mr F, the settlement team was in Hong Kong.

Summary and Comments on Evidence on Workflow and Sample Trade Documents
(Country 9, Country 10)

	Country 9	Country 10
The Group licensed to trade on exchange floor?	No Group company established in Country 9 was in the evidence. Always used local brokers on stock exchange of Country 9 through Company B-Country 3. Majority trades performed by Company Z who was later replaced by Company X.	Not known.
Notes / Comments	Oral testimony and references to sample documents provided by Mr E. There was a Group team in the local broker. 'Since [the Appellant] was recharged cost of research on [Country 9] market, 50% of the net commission from [Company B] (including [Cities 1 and 2] offices) was also allocated to [the Appellant]. After 1994 [Country 3] paid the [Country 9] research costs and as a result the shared commission attributable to [Cities 1 and 2] clients would be passed through [the Appellant] to [Company B].' What was the meaning of the last sentence? Did the Appellant receive the shared commission or not after 1994?	No sample documents were produced. Only Report I made reference to Country 10. Foreign investment in Country 10 securities was strictly controlled. Direct investment was not possible due to repatriation of funds issues. Segments of approved schemes were traded and clients had to post cash with the Group.
Passing on of client orders	Group sales desk directs or places orders by fax, phone or telex to 'Company B-City 11' (Note: no such company existed). Two sample telexes were supplied for one transaction for Country 9 securities. The transactions in this sample do not relate to the transactions in subsequent samples. Proprietary trading was done by a Group staff based in Hong Kong and his trade orders were treated like client orders (Report I).	Orders from various Group sales desks received in Hong Kong, not Country 10.
Trade in stock exchange or relevant market	The local third party broker of Country 9 executed the trade in the exchange. There is a Company B-Country 3 Country 9's dealing team in the broker of Country 9.	Local third party broker executed the order in the exchange. For the broker, the trading party was a Group company registered in Country 10 ???????

	Country 9	Country 10
Dealing ticket	Company B-Country 3's document titled '[Country 9] Trades'. One sample dealing ticket for each year under appeal were supplied for Country 9 securities. Six sample dealing tickets for each year under appeal were supplied. According to Report I, the broker of Country 9 informed Company B-Country 3 in Country 3 and Company B completed the trade tickets.	Hong Kong dealer wrote the dealing tickets.
Trade confirmation	Company B-Country 3 issued to client. Six sample telexes for each year under appeal were supplied and it stated that Company B-Country 3 had sold or bought on behalf of client.	
Contract note	Six sample contract notes for each year under appeal were supplied. Company B-Country 3 issued to clients stating Company B-Country 3 as agent has executed a trade order.	
Delivery advice	No samples were produced.	
Custodian and clearing services		
Other sample documents		
Booking	All booked to Company B-Country 3. According to Mr J, this was because Country 3 enjoyed reciprocal tax arrangements with Country 9. If a Country 9 broker's counter-party to a trade was a Country 3 entity (which Company B-Country 3 was), capital gain tax exemptions applied.	
How client paid commission and how this commission was shared	Mr E said that client paid to Company B-Country 3. Until 1994, Company B-Country 3 paid 50% net commission to the Appellant for both Asian client orders or City 1 and European orders of Company B. There was no distinction based on the originating country of client or trade order. Mr E said that after 1994, the commissions relating to Company B received by the Appellant were passed on to Company B. We do not know how it was passed on to Company B. And it implied that prior to 1994, the Appellant did not pass on the Company B originating clients or trade orders to Company B.	

	Country 9	Country 10
Trade settlements and payments for and deliveries of securities	According to Mr E. Company B-Country 3 maintained its own settlement system for Country 9 trades and exclusively handled these functions. Report I mentioned that trades were entered into the Country 3 settlement computer settlement system once the booking accounts are known.	