Case No. D17/10

Profits tax – prescribed assets – source of profits – sections 2, 14(1), 16(1), 16G(1) & (2), 17(1)(b) & (c), 66(1) & (3), 68(4),(7) & (9), 70A(1) of Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Anna Chow Mun Wah and Elaine Liu Yuk Ling.

Date of hearing: 16 June 2009.
Date of decision: 30 July 2010.

By consent, the appeals of A1, A2 and A3 ('the appellants') were consolidated and heard together. A1's ground of appeal was that its expenditure on prescribed assets should be allowable expenses. A2 and A3's grounds of appeal were similar in that they both claimed that they did not carry on any business in Hong Kong. The three appeals, in the way that they were presented to the Board, were found by the Board to be frivolous, vexatious and an abuse of the appeal process.

Held:

1. The only witness statement which the appellants lodged with the Clerk was a one page statement of W1, dealing in very general terms with the mode of operation of the 3 appellants. W1's witness statement was uninformative, lacking in material particulars and completely silent on most of the issues raised by the grounds of appeal. No explanation was offered for the sloppy preparation. In the exercise of its discretion, the Board did not allow W1's testimony to depart substantially from her witness statement. (Ng Kam-chun Stephen (Trading as Chun Mou Estate Agency) v Chan Wai-Hing, Janet and others [1994] 2 HKLR 89 applied)

2. In regard to A1's appeal, section 16G is an exception to the rule under section 17 that expenditure of a capital nature is not deductible. To come within the exception, a taxpayer must satisfy the requirement under sections 16(1) and 16G(2) that the expenses were incurred in the production of chargeable profits. Section 68(4) provides that the burden of proving that the assessment appealed against is excessive or incorrect is on the taxpayer. There was no evidence on A1's expenditure on prescribed assets. A1's appeal was accordingly dismissed as he had not discharged its burden of proving that any of the assessments appealed against is incorrect or excessive. Further and in any event, the relevant items of expenditure could not and did not qualify as

prescribed assets, and further and in any event, there was no evidence that they had been incurred for the production of A1's chargeable profits.

3. As for A2 and A3's appeals, three conditions must be satisfied before a charge to tax can arise under section 14 of the IRO: (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,' meaning 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. Given W1's admission that there were actual sales and purchases between A1 and A2 and actual sales and purchases between A1 and A3, the three conditions under section 14 were all satisfied. Further and in any event, based on the facts found by the Board, the first two conditions were both satisfied in respect of A2 and A3.

Appeal dismissed and costs order in the amount of $5,000 imposed.

Cases referred to:

Commissioner of Inland Revenue v Hang Seng Bank Limited [1991] 1 AC 306
Commissioner of Inland Revenue v HK-TVB International Limited [1992] 2 AC 397
Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Limited 3 HKTC 703
Orion Caribbean Limited (in voluntary liquidation) v Commissioner of Inland Revenue [1997] HKLRD 924
Kwong Mile Services Limited v Commissioner of Inland Revenue (2004) 7 HKCFAR 275
Kim Eng Securities (Hong Kong) Limited v Commissioner of Inland Revenue (2007) 10 HKCFAR 213
ING Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue (2007) 10 HKCFAR 417
FL Smidth & Co v Greenwood [1921] 3 KB 583
China Map Limited v CIR (2008) 11 HKCFAR 486
Chinachem Investment Company Limited v Commissioner of Inland Revenue (1987) 2 HKTC 261
Harley Development Inc & another v Commissioner of Inland Revenue
Ng Kam-chun Stephen (Trading as Chun Mou Estate Agency) v Chan Wai-Hing, Janet and others [1994] 2 HKLR 89

Wong Fu Kei, Certified Public Accountants, for the taxpayer.
Peter Ng Senior Counsel instructed by Carmen Y M Chan, Senior Government Counsel of the Department of Justice for the Commissioner of Inland Revenue.

Decision:

Consolidation of appeals

1. A1 is the appellant in BR82/08. A2 is the appellant in BR83/08. A3 is the appellant in BR84/08. A1, A2 and A3 are referred to collectively as 'the appellants'.

2. By consent of the appellants and the respondent, these 3 appeals were consolidated and heard by the same panel of Board of Review ('the Board') members.

Pre-hearing preparations and directions

3. In early 2003, the Inland Revenue Department ('the Revenue') began its tax audits on the appellants. Various profits tax assessments were issued to the appellants during or after the tax audits.

4. Mr Wong Fu Kei, a certified public accountant, has since about 1 June 2004 been the appellants' tax representative in the tax audits. He also represented the appellants in these appeals, referring to the appellants as his 'clients'. Be that as it may, he told us that he was not a practising certified public accountant.

5. By letter dated 30 April 2009, the Clerk to the Board of Review ('the Clerk') informed the appellants and the respondent:

(a) that 2 whole days, i.e. 16 and 17 June 2009, had been fixed for the hearing of the appeals; and

(b) of the Board's directions that:

(1) the appellants should send the Clerk a bundle of the documents which they wished to rely on, witness statements of the witnesses they intended to call and authorities which they wished to cite in support of their appeal by 29 May 2009; and

(2) the respondent should send the Clerk her bundle of documents, witness statements and authorities by 5 June 2009.

6. On 29 May 2009, Mr Wong sent the Clerk 3 hearing bundles – bundle A, bundle B and bundle C. There are over 1,000 pages of copy documents in these 3 bundles.

7. By letter dated 4 June 2009, Ms Carmen YM Chan, senior government counsel, wrote to the Clerk asking for an extension of time to 11 June 2009 for lodging the respondent's bundle of authorities and the respondent lodged her bundle of documents on 5 June 2009 and her bundle of authorities on 10 June 2009.

No attempt by appellants to agree facts which were not in dispute

8. The appellants made no attempt to respond to the respondent's invitation to agree facts which were not disputed. The Board has said time and again that facts are to be agreed or proved and that facts are not proved by mere assertions made by tax representatives.

The hearing of the appeals

(i) Attempt to lodge a large bundle at the hearing

9. At the commencement of the hearing on 16 June 2009, Mr Wong attempted to lodge a 328-page bundle, bundle D.

10. Mr Peter Ng SC, counsel for the respondent, objected to the inclusion of bundle D as part of the hearing bundles.

11. Through Mr Wong, the appellants asserted that:

> ' There is some information we have difficulty to locate because all the vouchers and accounting records were with the revenue.'

12. It was incumbent on the appellants to convince the Board that it should exercise its discretion in their favour to allow late lodging of documents which ran to 328 pages. The Revenue would need time to peruse the documents and consider whether to submit any document or authority in response and it was probable that the scheduled 2-day hearing would have to be adjourned.

13. We are not satisfied that the only reason put forward by the appellants was bona fide or relevant:

(1) We fail to see any link between the vouchers and the documents in bundle D.

(2) Mr Wong made no attempt to demonstrate any link between the accounting records and bundle D.

(3) Mr Wong had since about 1 June 2004 been the appellant's tax representative in the tax audit. If the vouchers or accounting records were relevant, he should have asked the Revenue for their return or for copies of them. When pressed by the Board, Mr Wong admitted that he had never asked the Revenue for the vouchers or the accounting documents. It was the appellants' fault not to have asked the Revenue for the

appellants' documents which were said to be with the Revenue and were said to be relevant to the appeals.

(4) The fact that Mr Wong was able to compile bundle D in the absence of documents said to be with the Revenue shows that the reason put forward was neither bona fide nor relevant and that bundle D could have been lodged in good time had the appellants exercised due diligence in their preparation.

14. The appellants have failed to persuade us that our discretion should be exercised in their favour to allow the late lodging of bundle D and we decline to do so.

(ii) Unavailability of the only witness

15. Within 15 minutes of the commencement of the hearing on 16 June 2009, Mr Wong announced that his witness would come in the afternoon.

16. The Board expected that scheduled hearings would be effective and would proceed smoothly. Neither taxpayers nor their representatives nor the Revenue should assume that adjournments were for the asking.

17. Mr Wong was told that the Board was not there to wait for his clients' attendance and if he did not proceed, the appellants risked the dismissal of the appeals. With considerable reluctance, the Board stood the hearing down for 20 minutes. The witness turned up a little more than 30 minutes later.

(iii) Attempt to adduce evidence not covered by witness statement

18. The only witness statement which the appellants lodged with the Clerk was a one page statement of W1, dealing in very general terms with the mode of operation of the 3 appellants.

19. More than 10 years ago, Keith J (as he then was) spelt out the following requirements of a witness statement in Ng Kam-Chun Stephen (Trading as Chun Mou Estate Agency) v Chan Wai-Hing, Janet and others [1994] 2 HKLR 89 at page 90:

> *'The witness statement should contain the whole of the witness evidence in the detail in which the witness would have given it if his evidence had been elicited by oral questions at the trial. Anything less than that prevents the statements from serving the purposes which they are intended to achieve - saving time, eliminating any element of surprise in the witnesses' evidence, enabling the parties to know the full strength of the case they have to meet, and enabling counsel to prepare a crisp and effective cross-examination.'*

20. Keith J went on to warn[1] that:

> *'I give notice to the profession that, unless there is a good explanation for a witness statement not properly covering the areas on which supplementary questions are sought to be asked, I shall be unlikely to give leave, pursuant to 0. 38, r. 2A (5) (a), for evidence to be led from that witness on those topics.'*

21. As will be seen in paragraph 39 below, the grounds of appeal submitted asserted that deduction of expenditure on prescribed fixed assets, depreciation and interest should be allowed. Mr Wong attempted to lead evidence on the moulds. When asked whether there was anything in the witness statement about mould expenses, Mr Wong attempted to fudge the issue and said that it was not in 'this file' and that the witness could answer any question which the chairman or counsel for the respondent might wish to. Plainly there was nothing in the witness statement about expenditure on prescribed fixed assets, depreciation or interest.

22. W1's witness statement was uninformative, lacking in material particulars and completely silent on most of the issues raised by the grounds of appeal. No explanation was offered for the sloppy preparation. In the exercise of our discretion, we did not allow W1's testimony to depart substantially from her witness statement.

23. Insofar as Mr Wong attempted to ignore our ruling, we attach no weight to W1's testimony which was elicited in breach of our ruling.

(iv) Conduct of the appellants' appeals

24. Mr Wong was asked in the course of his submissions whether the appellants had put forward such a case before, Mr Wong said that it was in bundle D. We do not see how the appellants could get away from the fact that it was a new case put forward for the first time at the hearing.

25. Mr Wong then went on to assert a proposition of law 'according to case law'. When asked to make good his proposition, he alleged that '[the Chairman] wrote that'. When pressed, he said that he 'look[ed] at the main issue' and that he 'forgot all the facts, I only look at the main issue'. When further pressed, he said that he 'forgot'. At no time did he identify what the Chairman was said to have written.

(v) W1's testimony

26. W1 made the following material admissions in the course of her cross-examination:

[1] At page 90.

'Q. [W1], I put it to you that there were actual sales and purchases between [A1 and A3]?

A. Yes.

Q. I also put it to you that there were actual sales and purchases between [A1 and A2], the Hong Kong partnership?

A. [Witness nods]

Q. What is your answer?

A. Yes.

Q. Very well. Whatever [A2 and A3] did in relation to those sale and purchase transactions, they did it on their own behalf, not on behalf of [the offshore limited company]?

A. It is because [the offshore limited company] cannot receive anything or conduct any payments directly in Hong Kong.

Q. Is the answer "yes" to my question?

A. Yes.'

There was **no** re-examination.

27. That apart, W1 was both evasive and non-responsive. She asked questions in purported answer to questions in cross-examination. On her own testimony, she had precious little knowledge about the matters relevant to these appeals. She did not impress us as a credible witness.

28. We attach no weight to her testimony except the admissions quoted in paragraph 26 above.

The relevant statutory provisions

29. Section 2 provides, among others, that:

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

30. Section 14(1) provides that:

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

31. Section 16(1) provides that:

'*In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period ...'*

32. Section 16G(1) & (2) provide that:

'*(1) Notwithstanding anything in section 17, in ascertaining the profits of a person from any trade, profession or business in respect of which the person is chargeable to tax under this Part for any year of assessment, there shall, subject to subsections (2) and (3), be deducted any specified capital expenditure incurred by the person during the basis period for that year of assessment.*

(2) Where a prescribed fixed asset in respect of which any specified capital expenditure is incurred is used partly in the production of profits chargeable to tax under this Part and partly for any other purposes, the deduction allowable under this section shall be such part of the specified capital expenditure as is proportionate to the extent of the use of the asset in the production of the profits so chargeable to tax under this Part.'

33. Section 17(1)(b) & (c) provide that:

'*(1) For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of –*

...

(b) subject to section 16AA, any disbursements or expenses not being money expended for the purpose of producing such profits;

(c) any expenditure of a capital nature or any loss or withdrawal of capital ...'

34. Sections 66(1) & (3) provide that:

> '*(1) Any person (hereinafter referred to as the appellant) who has validly objected to an assessment but with whom the Commissioner in considering the objection has failed to agree may ... either himself or by his authorized representative give notice of appeal to the Board; but no such notice shall be entertained unless it is given in writing to the clerk to the Board and is accompanied by a copy of the Commissioner's written determination together with a copy of the reasons therefor and of the statement of facts and a statement of the grounds of appeal.'*
>
> '*(3) Save with the consent of the Board and on such terms as the Board may determine, an appellant may not at the hearing of his appeal rely on any grounds of appeal other than the grounds contained in his statement of grounds of appeal given in accordance with subsection (1).'*

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

36. Section 68(7) provides that:

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

37. Section 68(9) provides that:

> '*Where under subsection (8), the Board does not reduce or annul such assessment, the Board may order the appellant to pay as costs of the Board a sum not exceeding the amount specified in Part I of Schedule 5, which shall be added to the tax charged and recovered therewith.'*
>
> The amount specified in Part I of Schedule 5 is $5,000.

38. Section 70A(1) provides that:

> '*Notwithstanding the provisions of section 70, if, upon application made within 6 years after the end of a year of assessment or within 6 months after the date on which the relative notice of assessment was served, whichever is the later, it is established to the satisfaction of an assessor that the tax charged for that year of assessment is excessive by reason of an error or omission in any return or statement submitted in respect thereof, or by reason of any arithmetical error or omission in the calculation of the amount of the net assessable value (within*

the meaning of section 5(1A)), assessable income or profits assessed or in the amount of the tax charged, the assessor shall correct such assessment:

Provided that under this section no correction shall be made to any assessment in respect of an error or omission in any return or statement submitted in respect thereof as to the basis on which the liability to tax ought to have been computed where the return or statement was in fact made on the basis of or in accordance with the practice generally prevailing at the time when the return or statement was made.'

Appeal by A1 (BR82/08)

(i) A1's grounds of appeal

39. The grounds of appeal given by Mr Wong on behalf of A1 read as follows (written exactly as it stands in the original):

'The expenditure on prescribed assets and depreciation allowances together with the interest expenses thereon (as listed below and in paragraph (30) of the Commissioner's Determination Statement of facts) incurred during years of assessment 1996/1997 to 2004/2005 (both years inclusive) should be allowable expenses pursuant to Section 16(1) and Section 16G of the Inland Revenue Ordinance as these expenses were incurred in the production of profits chargeable to tax.

Years of Assessment	Depreciation Allowances	Prescribed Assets	Interest
	HK $	HK $	HK $
1996/1997	904,353	0	46,459
1997/1998	672,245	0	15,930
1998/1999	922,249	147,000	20,321
1999/2000	451,498	1,529,180	57,541
2000/2001	230,467	2,106,455	19,155
2001/2002	94,626	1,724,700	1,035
2002/2003	44,764	1,039,646	0
2003/2004	31,335	815,890	0
2004/2005	21,934	1,666,920	0
Total	3,373,471	9,029,791	160,441

'

40. Mr Wong told us that they had 'given up the appeals against the depreciation allowances and the interest in the machinery'.

(ii) Board's decision on A1's appeal

41. Section 16G is an exception to the rule under section 17 that expenditure of a capital nature is not deductible. To come within the exception, a taxpayer must satisfy the requirement under sections 16(1) and 16G(2) that the expenses were incurred in the production of chargeable profits. Section 68(4) provides that the burden of proving that the assessment appealed against is excessive or incorrect is on the taxpayer.

42. The effect of our ruling in paragraph 22 above is that Mr Wong was not allowed to lead oral evidence on the prescribed fixed assets point at all. His assertions, whether orally or in writing, gets the appellants nowhere.

43. A1 has not discharged its burden of proving that any of the assessments appealed against is incorrect or excessive. On this ground alone, the appeal should be dismissed.

44. Further and in any event, the import declarations[2] at B1 pages 456 – 459 submitted by the offshore limited company declared that the offshore limited company was the operating unit[3] and the recipient unit[4] and that the method of trading[5] was foreign capital equipment or installation[6]. The offshore limited company is and was a legal person, separate and different from A1, A2 or A3. Insofar as the items were capital injections by the foreign unit into the offshore limited company, the items became the assets of the offshore limited company and they ceased to be, if they ever had been, A1's assets. The items could not and did not qualify as prescribed fixed assets.

45. Further and in any event, there is no evidence that they were incurred for the production of A1's chargeable profits.

(iii) Disposition of BR 82/08 and costs order

46. We dismiss A1's appeal and confirm the assessments appealed against.

47. A1's appeal, in the way it was presented to the Board, was frivolous, vexatious and an abuse of the appeal process. It could only and did serve the purpose of wasting the Board's time and resources.

48. Pursuant to section 68(9) of the Ordinance, we order A1 to pay the sum of $5,000 as costs of the Board, which $5,000 shall be added to the tax charged and recovered therewith.

Appeals by A2 (BR 83/08) and by A3 (BR 84/08)

[2] 進口貨物報關單
[3] 經營單位
[4] 收貨單位
[5] 貿易方式
[6] 外資設備物

49. These 2 appeals can be taken together.

(i) Authorities on source of profit

50. Delivering their Lordships' advice in Commissioner of Inland Revenue v Hang Seng Bank Limited [1991] 1 AC 306, Lord Bridge said that:

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

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

(c) *'The question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last analysis a question of fact depending on the nature of the transaction' (page 322).*

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

(e) *'The broad guiding principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profit in question' (pages 322-323).*

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

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

> '*One looks to see what the taxpayer has done to earn the profit in question and where he has done it.'*

Lord Jauncey went on to state that:

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

52. Fuad VP, delivering the leading judgment of the majority in Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Limited 3 HKTC 703, cited Lord Bridge's 'broad guiding principle' expressed in the Hang Seng Bank case, as expanded by Lord Jauncey in the HK-TVB case and continued (page 729):

> ' *"one looks to see what the taxpayer has done to earn the profit in question and where he has done it."*
>
> *When addressing the question the Board had formulated for itself "where did the operations take place from which the profits in substance arise", in my respectful judgment the Board did not appear to appreciate that it is the operations of the taxpayer which are the relevant consideration. If the Board had been able to benefit from the decisions of the Privy Council in the* ***Hang Seng Bank*** *and the* ***HK-TVB*** *case, I have little doubt the Board's general approach to the issues would not have been the same. I think that Miss Li was right when she submitted that the case stated clearly indicated that the Board had looked more at what the overseas brokers had done to earn their profits. Of course, there would have been no "additional remuneration" ultimately credited to the Taxpayer if the brokers had not executed the relevant transactions, and these took place abroad, but this does not tell us what the Taxpayer did (and where) to earn its profit. The Taxpayer, it seems to me, while carrying on business in Hong Kong, instructed the overseas broker from Hong Kong to execute a particular transaction. The Taxpayer was carrying out its contractual duties to its client and performing services under the management agreement in Hong Kong and in return receiving the management fee as well as*

the "additional remuneration as manager" to which it was entitled under that agreement. In my view, the Taxpayer did nothing abroad to earn the profit sought to be taxed. The Taxpayer would be acting in precisely the same manner, and in the same place, to earn its profit, whether it was giving instructions, in pursuance of a management contract, to a broker in Hong Kong or to one overseas. The profit to the Taxpayer was generated in Hong Kong from that contract although it could be traced back to the transaction which earned the broker a commission.'

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

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

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

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

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

55. In Kim Eng Securities (Hong Kong) Limited v Commissioner of Inland Revenue (2007) 10 HKCFAR 213, Bokhary PJ regarded it as well established that:

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

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

56. In ING Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue (2007) 10 HKCFAR 417, Ribeiro PJ said that:

> *'In Kwong Mile Services Ltd v Commissioner of Inland Revenue, applying the abovementioned authorities, this Court noted the absence of a universal test but emphasised "the need to grasp the reality of each case, focusing on effective causes without being distracted by antecedent or incidental matters."*[7] *The focus is therefore on establishing the geographical location of the taxpayer's profit-producing transactions themselves as distinct from activities antecedent or incidental to those transactions. Such antecedent activities will often be commercially essential to the operations and profitability of the taxpayer's business, but they do not provide the legal test for ascertaining the geographical source of profits for the purposes of section 14' (paragraph 38).*

Lord Millett NPJ said that:

(a) *'Wardley*[8] *has been correctly decided. The taxpayer was acting as a fiduciary in investing its clients' funds. The sole basis upon which it was entitled to receive and keep for itself a negotiated rebate on commission paid to effect trades on its clients' behalf was the management agreement which it was performing in Hong Kong. It would otherwise have come under a duty to account to the clients for the rebated sums which represented a reduction in the expenses incurred in effecting trades on clients' behalf. What produced the profit was therefore performance of the contract in Hong Kong and not the effecting of the trades offshore' (at paragraph 112).*

(b) *'The operations "from which the profits in substance arise" to which Atkin LJ referred*[9] *must be taken to be the operations of the taxpayer from which the profits in substance arise; and they arise in the place where his service is rendered or profit-making activities are carried on. There are thus two limitations: (i) the operations in question must be the operations of the taxpayer; and (ii) the relevant operations do not comprise the whole of the taxpayer's operations but only those which produce the profit in question' (paragraph 129).*

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

[7] (2004) 7 HKCFAR 275 at 283G, per Bokhary PJ.
[8] Lord Millett NPJ cited part of the passage cited in paragraph 52 above.
[9] The judgment of Atkin LJ in FL Smidth & Co v Greenwood [1921] 3 KB 583 at 593.

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

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

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

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

(ii) A2's grounds of appeal

57. The grounds of appeal given by Mr Wong dated 20 January 2009 on behalf of A2 read as follows (written exactly as it stands in the original):

'I am writing to appeal, on behalf of my above-named client, to the Profits Tax assessments issued to and determined on [A2] for years of assessments 1996/1997, 1997/1998, 1998/1999, 1999/2000, and 2000/2001

(details and amounts of which as listed in Appendix 1 herewith). The grounds of appeal are as follows:

Grounds of Appeal

(A2) did not carry on any business in Hong Kong during years of assessments 1996/1997, 1997/1998, 1998/1999, 1999/2000 and 2000/2001. It only invested in a factory in [... China, the offshore limited company] where the finished products were sold and invoiced directly by the [the offshore limited company] to [A1]. The manufacturing process took place completely in the factory [offshore]. There were no activities carried out by [A2] in Hong Kong except to deliver the finished products to [A1]. Therefore the Profits Tax assessments for those years as determined by the Commissioner of Inland Revenue should be annulled.'

(iii) A3's grounds of appeal

58. The grounds of appeal given by Mr Wong on behalf of A3 read as follows (written exactly as it stands in the original):

'I am writing to appeal, on behalf of my above-named client, to the Profits Tax assessments issued to and determined on [A3] for years of assessments 2001/2002, 2002/2003, 2003/2004, and 2004/2005 (details and amounts of which as listed in Appendix 1 herewith). The grounds of appeal are as follows:

Grounds of Appeal

[A3] did not carry on any business in Hong Kong during years of assessments 2001/2002, 2002/2003, 2003/2004, and 2004/2005. It took over the business of [A2] and continued to manage its invested factory [the offshore limited company in [China] where the finished products were one hundred percent manufactured there. There were no activities carried out by [A3] in Hong Kong except to deliver the finished products to [A1]. Therefore the Profits Tax assessments for those years as determined by the Commissioner of Inland Revenue should be annulled.'

(iv) Appellants bound by the grounds of appeal

59. The appellants are bound by their respective grounds of appeal. The grounds restricted the scope of evidence to be adduced before the Board[10]. Unless permitted by the Board under section 66(3), the appeal is confined to the original grounds of appeal[11].

[10] Section 68(7).
[11] China Map Limited v CIR (2008) 11 HKCFAR 486 at paragraphs 9 & 10.

Applications for the Board's consent to amend the grounds of appeal 'should be sought fairly, squarely and unambiguously'[11].

60. Mr Wong made no application to amend any of the grounds of appeal despite having been warned by Mr Ng that the appellants were not entitled to rely on any ground not in the grounds of appeal. It follows that the appellants cannot rely on any ground of appeal not in the original grounds.

(v) General comments and decision on the grounds of appeal

61. As stated in paragraph 50 above, 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.

62. A2's and A3's grounds of appeal seemed to be directed primarily at the first condition and it is questionable whether it raised an issue on the third condition. Ambiguous grounds of appeal are not helpful.

63. So far as A3 is concerned, A3 applied to the assessor to invoke section 70A to correct 4 profits tax and additional profits tax assessments for the 3 years of assessment from 2001/02 to 2003/04. The assessor refused to do so and the refusal was upheld by the Deputy Commissioner. A3's grounds of appeal raise no issue under section 70A and A3's appeal in respect of those 4 assessments fail for want of any ground of appeal and must be dismissed.

(vi) First and second conditions

64. The admissions referred to in paragraphs 67 – 70 below are fatal to both A2 and A3 in respect of the first and second conditions.

65. Further and in any event, as pointed out by the Deputy Commissioner and we find as facts that:

(1) A2 was a partnership business established in Hong Kong. Its place of business was in Hong Kong. It prepared its accounts in Hong Kong and maintained its business records in Hong Kong. It opened a bank account in Hong Kong for business purposes and its expenses in 1999/2000 amounted to $12,183,994.

(3) A3 was a limited company registered in Hong Kong. Its place of business was in Hong Kong. Staff were employed in Hong Kong to handle clerical work, transportation, casting and customs declaration for import and export. It opened bank accounts in Hong Kong. Book-keeping and

> business records keeping and preparation of financial statements were carried out in Hong Kong. Some of its audited financial statements showed that there were business transactions between it and A1. Mr Wong felt able to assert that those statements were erroneous. But his bare assertions are not enough[12].

66. We agree with the Deputy Commissioner that the first two conditions are satisfied in respect of both A2 and A3.

(vii) The third condition

67. W1 accepted on oath that there were actual sales and purchases between A1 and A2 and actual sales and purchases between A1 and A3. The appellants are bound by W1's admission.

68. The explanation put forward by W1 and Mr Wong are by no means convicting and we reject it.

69. In any event, the appellants are bound by the form of their transaction[13].

70. As Lord Millett NPJ held[14] in ING Baring Securities, the source of profits of the offshore limited company cannot be ascribed to the activities of A2 or A3.

71. The admission of actual sales and purchases between A1 and A2 and of actual sales and purchases between A1 and A3 are fatal to both A2 and A3 in respect of the third condition.

(viii) Conclusion in respect of A2's appeal (BR83/08)

72. A2's appeal should be dismissed and the assessments appealed against confirmed.

73. A2's appeal, in the way it was presented to the Board, was frivolous, vexatious and an abuse of the appeal process. It could only and did serve the purpose of wasting the Board's time and resources.

74. Pursuant to section 68(9) of the Ordinance, we, in our decision in BR 83/08, shall order A2 to pay the sum of $5,000 as costs of the Board, which $5,000 shall be added to the tax charged and recovered therewith.

(ix) Conclusion in respect of A3's appeal (BR84/08)

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[12] See Chinachem Investment Company Limited v Commissioner of Inland Revenue (1987) 2 HKTC 261 at page 302 and on appeal at page 308

[13] Per Penlington JA in Harley Development Inc. & another v Commissioner of Inland Revenue at page 110.

[14] See paragraph 56 above.

75. A3's appeal should be dismissed and the assessments appealed against confirmed.

76. A3's appeal, in the way it was presented to the Board, was frivolous, vexatious and an abuse of the appeal process. It could only and did serve the purpose of wasting the Board's time and resources.

77. Pursuant to section 68(9) of the Ordinance, we, in our decision in BR 84/08, shall order A3 to pay the sum of $5,000 as costs of the Board, which $5,000 shall be added to the tax charged and recovered therewith.